86-1593

No. A-550

Supreme Court, U.S.
FILED
MAR 20 1987
JOSEPH F. SPANIOL, JR.
CLERK

In The Supreme Court Of The United States

October Term, 1986

Shell Oil Company,
Appellant

vs.

Department of Revenue,
State of Florida,
Appellee

Appeal

from the Supreme Court of Florida

Jurisdictional Statement

J. Lloyd Kennedy
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 77252
(713) 241-3386

Of Counsel

Arthur J. England, Jr.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

Attorney for Appellant

Question Presented

Is the State of Florida prohibited by the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a)(2) (1972), and Article VI, clause 2, the Supremacy Clause of the United States Constitution, from imposing a tax on the income earned by Shell from the production of oil and gas on the outer Continental Shelf, irrespective of whether that production income is derived from a sale of oil and gas to independent third parties on the Shelf itself or from a transfer on the Shelf into pipelines for transport and eventual sale within the United States.

Table of Contents

Page

Question Presented.....i

Index to Appendices.....iii

Table of Authorities.....v

Opinions Below.....1

Jurisdiction.....2

Constitutional Provision and Statutes.....4

Statement of the Case.....5

Reasons for Plenary Consideration.....14

Conclusion.....23

The real parties in interest of this case are Shell Oil Company and the State of Florida. Shell's parent corporation is SPNV Holdings, Inc., which, in turn, is owned by Shell Petroleum N.V. The latter's parents are Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). Shell Oil Company

Index to Appendices

Page

1. Shell Oil Company v. Department of Revenue, 496 So.2d 789 (Fla. 1986).....1-1

2. Shell Oil Company v. Department of Revenue, 461 So.2d 959 (Fla. 1st DCA 1984).....2-1

3. Final Summary Judgment in Shell Oil Company v. Department of Revenue, Case No. 80-987, Circuit Court of the Second Judicial Circuit of Florida, in and for Leon County, Florida.....3-1

4. Florida Supreme Court order denying rehearing in Shell Oil Company v. Department of Revenue, November 24, 1986.....4-1

---

itself owns directly or indirectly, both 100% and less than 100% stock interests in approximately one hundred and twenty (120) corporations that operate both in the United States and in foreign countries. All of the companies are often referred to collectively as the "Royal Dutch/ Shell Group of Companies." Counsel is advised that there are subsidiaries, not wholly owned, and affiliates throughout the world of this group which, in the aggregate, are so numerous that they could not be determined or identified for the Court within the time frame for filing this jurisdictional statement.

Index to Appendices
(continued)

Page

5. Notice of Appeal.....5-1

6. Article VI, clause 2, United States Constitution.....6-1

7. 43 U.S.C § 1331(a) (1972).....7-1

8. 43 U.S.C § 1301 (1972).....8-1

9. 43 U.S.C § 1333(a) (1972).....9-1

10. Section 220.02(4)(a), Florida Statutes (Supp. 1972).....10-1

11. Section 220.02(5), Florida Statutes (Supp. 1972).11-1

12. Section 220.15, Florida Statutes (Supp. 1972).12-1

13. Section 214.71, Florida Statutes (1971).....13-1

Table of Authorities

Cases — Page

Amerada Hess Corp. v. Alaska, Department of Revenue
No. 3AN-84-05016 (Alaska 3d Cir. Super. Ct.).....22

Maryland v. Louisiana
451 U.S. 725 (1981).....18,19

Shell Oil Company v. Iowa, Department of Revenue
No. 86-1565 (Iowa Supreme Court)....22

Shell Oil Company v. Department of Revenue
496 So.2d 789 (Fla. 1986).....1,8,14

Shell Oil Company v. Department of Revenue
461 So.2d 959 (Fla. 1st DCA 1984)....1

United States v. California
332 U.S. 19 (1947).....17

United States v. Louisiana
339 U.S. 699 (1950).....18

United States v. Texas
339 U.S. 707 (1950).....18

Constitution and Statutes

Article VI, clause 2, United States Constitution.....i,2,4

28 U.S.C. § 1257(2) (1985).....2

28 U.S.C. § 1257(3) (1985).....2

28 U.S.C. § 2103 (1985).....3

43 U.S.C. § 1301 (1972).....4,5

43 U.S.C. § 1331(a) (1972).....4,5

43 U.S.C. § 1333(a) (1972).....4

43 U.S.C. § 1333(a)(2)
(1972).....i,2,6,8,19

Section 214.71,
Florida Statutes (1971).....4,10

Section 220.02(4)(a),
Florida Statutes (Supp. 1972).....4,10

Section 220.02(5),
Florida Statutes (Supp. 1972).....4,10

Section 220.15,
Florida Statutes (Supp. 1972).....4,10

Section 220.15(3), Florida Statutes
(Supp. 1972).....12

Other

99 Cong. Rec. 7234, 7261 (1953)....16,17

S. Rep. No. 411, 83rd Cong.,
1st Sess. (1953).....16

Opinions Below

The decision of the Supreme Court of Florida being appealed is reflected in an opinion reported as Shell Oil Company v. Department of Revenue, 496 So.2d 789 (Fla. 1986). A copy of the opinion appears as Appendix 1. A decision of the First District Court of Appeal of Florida is reflected in an opinion reported as Shell Oil Company v. Department of Revenue, 461 So.2d 959 (Fla. 1st DCA 1984). A copy of the district court's decision appears as Appendix 2. An initial final summary judgment entered by the Circuit Court of the Second Judicial Circuit of Florida, in and for Leon County, Florida, is unreported. A copy of this judgment appears as Appendix 3.

Jurisdiction

The appellate jurisdiction of the Court is invoked under 28 U.S.C. § 1257(2) (1985). The decision of the Florida Supreme Court upholds a construction of the state's corporate income tax code, Chapter 220, Florida Statutes, which is repugnant to the ban on state taxation contained in 43 U.S.C. § 1333(a)(2) (1972), the Outer Continental Shelf Lands Act. By rejecting the express prohibition in that federal statute, the decision below violates the Supremacy Clause in Article VI, clause 2 of the United States Constitution.

Alternately, Shell invokes the jurisdiction of the Court under 28 U.S.C. § 1257(3) (1985), on the dual grounds that Florida's income tax code is repugnant to federal law and that Shell's asserted rights are claimed under the Supremacy

Clause of the United States Constitution. Alternative treatment of the appeal as a petition for certiorari is authorized by 28 U.S.C. § 2103 (1985).

The decision of the Florida Supreme Court was entered on April 24, 1986, but did not become final until the denial of rehearing on November 24, 1986. (The order on rehearing appears as Appendix 4). A timely notice of appeal was filed in that court on January 28, 1987. (Appendix 5). On the same day, Shell requested an extension of time for docketing its jurisdictional statement. That request was granted by Justice Powell on January 30, extending the date of docketing to March 23, 1987.

Constitutional Provision and Statutes

This case involves the following provisions of law, each of which is reproduced verbatim in the appendix.

1. Article VI, clause 2 of the United States Constitution (Appendix 6);

2. 43 U.S.C. § 1331(a) (1972), a part of the Outer Continental Shelf Lands Act (Appendix 7);

3. 43 U.S.C. § 1301 (1972), a part of the Submerged Lands Act (Appendix 8);

4. 43 U.S.C. § 1333(a) (1972) (Appendix 9);

5. Section 220.02(4)(a), Florida Statutes (Supp. 1972) (Appendix 10);

6. Section 220.02(5), Florida Statutes (Supp. 1972) (Appendix 11);

7. Section 220.15, Florida Statutes (Supp. 1972) (Appendix 12);

8. Section 214.71, Florida Statutes (1971) (Appendix 13).

Statement of the Case

Shell is a multistate corporation whose business includes the extraction or production of oil and gas on the outer Continental Shelf of the United States. The Shelf is defined by federal law to be, essentially, the underwater lands more than three miles from the shore of any state of the United States. 43 U.S.C. §§ 1331(a) and 1301 (1972). (Appendices 7 and 8). No portion of the Shelf is located in the State of Florida or any other of the fifty states.

The federal government maintains exclusive ownership and control of Shelf lands. 43 U.S.C. § 1331(a) (1972). (Appendix 7). Shell's right to conduct exploration and production activities on the Shelf was acquired by lease from the United States government. For this privilege, Shell bid for the right of

exploration and production on the Shelf and pays the United States a lease bonus, a delay rental, and a royalty on its oil and gas production which results from these activities which is measured at the wellhead. By federal law, no taxes, fees or royalties of any kind are payable to any state on this production. Congress has said: "State taxation laws shall not apply to the outer Continental Shelf." 43 U.S.C. § 1333(a)(2) (1972). (Appendix 9).

In non-technical terms, outer Continental Shelf production activity involves platform drilling into lands below the oceans and seas more than three miles from the territorial limits of the state. The production process consists of the physical acts of erecting platforms, drilling into the seabed, extracting mineral products (oil and gas) from beneath the seabed, delivering

them up onto the drilling platform, and then causing their transfer into pipes or barges for delivery to landside receiving points in any one or more of the several states.

Net income in significant amounts was attributable to Shell's production of oil and gas on the Shelf in its fiscal years 1972-75. These amounts represented transfer prices for crude oil and natural gas delivered to pipelines at the producing platforms on the Shelf, less related costs and expenses. In the case of natural gas, all transfers were made by sale to non-affiliated, independent pipeline companies which rent space and take delivery of the gas on the platform. In the case of crude oil, some transfers were made by sale to independent third parties on the platform, but most were delivered to Shell's own pipeline for transport to shore.

Neither Shell nor any other petroleum company refines or otherwise changes the character of crude oil on Shelf platforms.

Sales of natural gas and crude oil to independent third parties are concluded transactions on the Shelf which constitute and have been treated by Shell as taxable events for federal income tax purposes. Based on the prohibition contained in federal law with respect to the outer Continental Shelf, as expressed in 43 U.S.C. § 1333(a)(2) (1972), Shell excluded its earnings from Shelf sales from its taxable income reportable for Florida income tax purposes. The Department of Revenue conceded to the Florida Supreme Court that actual sales consummated on Shelf platforms are beyond Florida's reach, by reason of section 1333(a)(2). Shell Oil Company v. Department of Revenue, 496

So.2d 789, 790 (Fla. 1986). (Appendix 1).

The transfer of crude oil into Shell's pipeline at the platform represents the final step of Shell's production activities on the Shelf. These activities generated earnings which Shell excluded from its income for Florida income tax purposes. These earnings were measured by reference to the fair market value of crude oil at the wellhead, the required method of determining a sales equivalent for computing royalties paid to the United States government for Shelf leases, for computing income from Shelf property under sections 613 and 613A of the Internal Revenue Code where there have been no sales to independent third parties, and for computing the federal windfall profit tax.

Florida's corporate income tax basically tracks federal taxable income, apportioned to the state on the basis of a three-factor formula using payroll, property and sales. §§ 220.02(4) and (5), 220.15, Fla. Stat. (Supp. 1972) and § 214.71, Fla. Stat. (1971) (Appendices 10, 11, 12, 13). For each of the years in controversy, Shell excluded from its adjusted federal income apportionable to Florida all Shelf oil and gas production revenue from sales and transfers on the Shelf, less costs and expenses related to that production income. For the tax years in question, Shell not only excluded from Florida reportable income all its Shelf production income, but for consistency it correspondingly excluded from the denominator of its Florida apportionment formula the real and tangible personal property located on the Shelf for those years, the payroll

attributable to production on the Shelf, and the sales on the Shelf as measured by sales or by wellhead transfer prices.

On audit, the Department of Revenue rejected Shell's exclusion of Shelf income and assessed additional corporate income tax by including all Shelf production earnings in apportioned taxable income. The Department asserted that this income, for Florida tax purposes, was generated by the realization of funds when Shell eventually sold the gas and oil (after refining) within the several states of the United States. (As indicated, the Department subsequently conceded Florida's legal inability to tax sales to independent third parties on the Shelf, thus excluding all sales of gas.)

For the purpose of computing the tax due, the Department went further and included Shelf-derived oil and gas sales

in the denominator of the apportionment formula. It refused to include in the denominator the payroll and property which Shell employed in extracting the oil and gas from beneath the sea, however, despite the fact that Shelf properties alone were valued up to two billion dollars for the tax years in question and represented up to 19% of Shell's United States properties in those years. The Department's basis for excluding Shelf payroll and property was its contention that these costs did not fit within the statutory definition of "everywhere" under the apportionment formula. See section 220.15(3), Florida Statutes (Supp. 1972). (Appendix 12). The effect of these adjustments was to tax Shell on all its Shelf production income, yet allow no correlative benefit in computing Florida's share for the payroll and property which generated that income.

Shell brought suit in Leon County Circuit Court, challenging the Department's assessment for the years in question. In order to crystallize the issue of total exclusion of Shelf production income by reason of the prohibition contained in the federal statute (as also required by Florida law itself, see Appendices 11 and 12), Shell withdrew its assertion that payroll and property should be included in the denominator of Florida's apportionment formula before the trial court entered final summary judgment.

The trial court held that federal law did not prevent the inclusion of Shelf production earnings in Florida's tax base, and it entered summary judgment against Shell with respect to the exclusion of Shelf production income. (Appendix 3). On appeal, the First District Court of Appeal affirmed the

trial court's inclusion of Shelf production income in Shell's apportioned taxable income for Florida income tax purposes. (Appendix 2). On further review in the Florida Supreme Court, the Department of Revenue conceded that income from the actual sale of oil and gas on platforms was not taxable. Shell Oil Company v. Department of Revenue, 496 So.2d 789, 790 (Fla. 1986). (Appendix 1). The Court, however, affirmed the inclusion of earnings from other transfers on the Shelf in Shell's Florida taxable income.

Reasons for Plenary Consideration

Congress debated long and hard over a twenty-six year period, from 1937 through 1953, to resolve the clash between state and federal interests about the mineral products derived from the outer Continental Shelf. Congressional resolution came in the form of the Outer

Continental Shelf Lands Act and the Submerged Lands Act, both of which declared federal sovereignty over the Shelf, established exclusive federal rights to Shelf interests, and expressly barred state intrusion on those rights. In the Outer Continental Shelf Lands Act, Congress expressly banned state taxation of revenues from Shelf activity and products.

The statute manifested a policy decision by Congress that any form of state levy, direct or indirect, would adversely affect the amounts of revenue available to the federal government from the sale of leases for exploration and production on Shelf lands.

> It is the Committee's collective judgment that under the terms of S. 1901 as reported, State taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state. Paragraph (3) of Section 4(a) specifically commands that --

> The provisions of this section for adoption of the State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any state for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom. (emphasis added).

S. Rep. No. 411, 83rd Cong., 1st Sess. (1953).

When representatives of the State of Louisiana urged an amendment allowing the extension of state boundaries onto the outer Continental Shelf, in order to authorize the power to impose state taxes, Senator Cordon argued against the amendment stating: "Either the Outer Continental Shelf is territory where the sole jurisdiction, control, and right to tax in any form is in the United States, or it is not." 99 Cong. Rec. 7234 (1953). The Louisiana amendment was rejected, as was a last ditch argument

by Senator Long of Louisiana that services for Shelf workers would have to be paid for by increased state taxes "if the employers of these workers are subject neither to the State's severance tax, property tax, nor the tax on corporate profits." 99 Cong. Rec. 7261 (1953) (emphasis added).

From time to time, this Court has been called upon to settle disputes between the states and the federal government regarding Shelf properties or interests. On each occasion, the Court has held that Congress intended that the property and natural resources of the Shelf be considered a national, rather than a local resource.

In a trilogy of cases, the Court held that the federal government had paramount right to submerged lands even within the historic boundaries of California, Texas and Louisiana. United

States v. California, 332 U.S. 19 (1947); United States v. Texas, 339 U.S. 707 (1950); United States v. Louisiana, 339 U.S. 699 (1950).

> The marginal sea is a national, not a state concern. National interests, national responsibilities, national concerns are involved. The problems of commerce, national defense, relations with other powers, war and peace focus there.

United States v. Louisiana, 339 U.S. at 704. Congress' express prohibition against the application of state tax laws to the Shelf was called into consideration in Maryland v. Louisiana, 451 U.S. 725 (1981). At issue was the constitutionality of Louisiana's "first use" tax on natural gas brought into the state. Despite a declaration in the Louisiana statute that the tax was not imposed on the gas itself, and consequently was not a tax imposed by the state on Shelf production, the Court observed that the inevitable result of the state levy was

to tax Shelf production in contravention of the prohibition contained in 43 U.S.C. § 1333(a)(2) (1972).

> [A state] has no sovereign interest in being compensated for the severance of resources from federally owned OCS land.

Maryland v. Louisiana, 451 U.S. at 759. A focus of the Court's concern in analyzing the tax issue was the effect that Louisiana's tax would have on the prices bid for leases of Shelf exploration rights.

The several states are once again endeavoring to impose their taxes in ways designed to reap financial benefits from Shelf production revenues at the expense of the federal government. These efforts are centered on the use of state income tax laws to siphon off earnings from Shelf production income by attributing to the states a share of the Shelf income generated by multistate oil producing corporations. The mechanisms

for this approach are the apportionment provisions of state income tax statutes.

In concept, apportionment laws allow the assignment of net income to particular states by relating the in-state activities of corporate taxpayers to their nationwide activities. These statutes are being used to sweep into the state's revenue base the net income of oil production companies which is generated by Shelf production. Just as was the case with Louisiana's first use tax, however, these tax burdens on gas and oil producing companies must adversely affect the bid prices for Shelf lease rights which are payable to the federal government.

The use of state income tax statutes to garner revenues from Shelf production is just as devastating to future federal lease revenues as other forms of direct and indirect taxes. For one thing, the

effect is widespread because almost all states impose a corporate income tax and the oil and gas producing companies conduct business in virtually every state. For another, the threat to lease payments is exacerbated by the fact that there is no uniformity among the states in the factors or methodology of apportionment.

Florida's taxation of Shelf production revenues, as authorized by the Florida Supreme Court, is not unique in the country. Administrative agencies throughout the nation, as well as the courts in Florida, have given a free hand to their revenue personnel to tax Shelf production revenues through the manipulation of apportionment factors and formulae. These increased local tax burdens laid on the multistate oil producing corporations must inevitably lower revenues to the federal government

from leases for Shelf exploration and production -- precisely the result Congress attempted to forbid with its proscription that "state taxation shall not apply to the Shelf." The misuse of state apportionment formulae is presently being litigated in Alaska and Iowa, as well as in Florida. Amerada Hess Corp. v. Alaska, Department of Revenue, No. 3AN-84-05016 (Alaska 3d Cir. Super. Ct.); Shell Oil Company v. Iowa, Department of Revenue, No. 86-1565 (Iowa Supreme Court).

Florida's attempt to tax Shelf production income has a dual distinction. First, it is the most egregious distortion of an apportionment formula in the various state cases, by reason of the exclusion of payroll and property factors in the computation. Second, it is the first case squarely on this issue to reach this Court. As such, it presents

the Court with the unique opportunity to rescue national policy from a significant and widespread erosion of that policy in a single-issue adjudication. This case poses the issue of federal supremacy squarely. Shell raised the Outer Continental Shelf Lands Act as a bar to Florida's tax reach in filing its tax returns for 1972-75, and it has asserted the statute as a prohibition to the revenue department's proposed adjustments at each stage of this litigation.

Conclusion

Through its revenue department and its courts, the State of Florida has authorized a state income tax on net earnings from the production of oil and gas on the outer Continental Shelf. The revenues affected are not subject to state taxation, however. Congress and this Court have zealously protected the

federal government's lease revenues from Shelf properties. Florida's erosion of those revenues by the taxation of Shelf production income provides a clear and timely occasion for this Court to vindicate the express ban on such taxation in federal law.

The issue of federal supremacy has been squarely litigated and preserved. Either "state taxation laws shall not apply to the outer Continental Shelf," or they will be permitted to do so. Only this Court can decide.

Respectfully submitted,

Arthur J. England, Jr.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

J. Lloyd Kennedy
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 77252
(713) 241-3386

Appendix 1

SHELL OIL CO.

v.

DEPARTMENT OF REVENUE

Cite as 496 So.2d 789 (Fla. 1986)

SHELL OIL COMPANY,

Petitioner,

v.

DEPARTMENT OF REVENUE,

Respondent

Nos. 66240, 66154

SUPREME COURT OF FLORIDA

April 24, 1986.

Rehearing Denied November 24, 1986.

The Circuit Court, Leon County, Ben C. Willis, J., entered summary judgment subjecting income derived from sale of oil to corporate income tax, and oil company appealed and Department of

Revenue cross-appealed. The District Court of Appeal, Smith, J., 461 So.2d 959, affirmed and certified question. The Supreme Court, McDonald, J., held that: (1) state of Florida was not precluded by federal law from imposing tax upon income derived from sale in United States of oil extracted from Outer Continental Shelf, and (2) intangible drilling costs, expensed for federal income tax purposes, could not be added back into oil company's asset base when calculating property factor of apportionment formula for state income tax purposes.

Approved in part and quashed in part; certified question answered in the negative.

Boyd, C.J., dissented and filed opinion in which Shaw, J., concurred.

1. **Taxation 1002**

Oil company's realization of income on oil extracted from Outer Continental Shelf occurred at time of sale in United States, rather than at the wellhead, though oil company assigned wellhead price to oil, in that oil company did not derive any actual economic gain until time of sale. West's F.S.A. § 220.02(4)(a).

2. **Taxation 935**

State of Florida is not prohibited, by statute exempting Outer Continental Shelf from state taxation laws, from imposing Tax upon income derived from sale in the United States of oil extracted from Outer Continental shelf. Outer Continental Shelf Lands Act, § 4(a)(2), 43 U.S.C.A. § 1333(a)(2).

3. **Taxation 1005**

Intangible drilling costs which oil company elected to expense for federal income Tax purposes could not be added back into oil company's asset base when calculating property factor of apportionment formula for purposes of state taxation. West's F.S.A. §§ 214.70-214.73, 220.15(4), 220.42(1); 26 U.S.C.A. § 263(a,c).

Arthur J. England, Jr. and Sandra S. Barker of Fine Jacobson, Schwartz, Nash, Block and England, Miami, and William D. Peltz, Senior Tax Counsel and Elizabeth C. Burton, Tax Atty., Shell Oil Co., Houston, Tex., for petitioner.

Jim Smith, Atty. Gen., and Joseph C. Mellichamp, III, and Sharon A. Zahner, Asst. Attys. Gen., Tallahassee, for respondent.

McDONALD, Justice.

The First District Court of Appeal has certified the following question as one of great public importance:

> Whether the State of Florida is prohibited by U.S.C. § 1333(a)(2)(A) [sic] from imposing a tax upon income derived from the sale in the United States of oil extracted from the outer Continental Shelf?

Shell Oil Co. v. Department of Revenue, 461 So.2d 959, 963 (Fla. 1st DCA 1984).[1] This Court has jurisdiction pursuant to article V, section 3(b)(4), Florida Constitution. We answer the certified question in the negative, approving in part and quashing in part the opinion of the district court.

---

[1] In certifying the above question to this Court, the district court cited to the presently existing section 1333(a)(2)(A). For purposes of the instant case, we shall deal with this statute as it existed during the period relevant to our review, 43 U.S.C. § 1333(a)(2) (1970).

Shell Oil, a Delaware corporation, conducts business throughout the United States. Among its many activities, Shell operates a number of drilling platforms for the extraction of crude oil and natural gas from the outer continental shelf (OCS). Shell makes all transfers of OCS natural gas by sale to nonaffiliated independent pipeline companies that rent space on Shell's platforms. In the case of crude oil, Shell makes some transfers by sale to independent third parties, but Shell delivers most of the oil to its own pipeline for transport to shore. Shell treats all transfers, whether to third parties or to the pipeline, as taxable events for federal income tax purposes. Shell, however, excludes such earnings from its taxable income for Florida income tax purposes. The company determines the revenue which the transfers generate

based on the fair market value of crude oil at the wellhead less related expenses. Most of the oil extracted from the OCS wells is refined and sold in the United States.

The Florida Department of Revenue (DOR) disallowed Shell's exclusion of certain OCS production income from its Florida tax base for fiscal years 1972-75. The trial court agreed with DOR as to the exclusion. The court, however, ruled that Shell could include its intangible drilling costs (IDCs) in the property factor of Florida's tax apportionment formula. Both parties appealed, and the district court affirmed the trial court as to both issues. On rehearing, however, the district court certified the instant question to this Court. Following certification, both parties independently petitioned this Court for review. These

petitions have been consolidated for purposes of the case at bar.

Section 1333(a)(2) of the Outer Continental Shelf Lands Act states that state taxation laws shall not apply to the outer continental shelf. 43 U.S.C. § 1333(a)(2) (1970). Neither DOR nor Shell Oil disputes this, and both parties agree that the oil production in question is derived from the OCS. Further, DOR concedes that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by section 1333(a)(2). Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.

DOR contends that because Shell sold the oil within the boundaries of the fifty states, and not on the OCS,

the taxable event occurred within the reach of Florida's tax laws. On the other hand, Shell contends that the time and location of the actual sale are irrelevant because no sale of OCS production can ever be subject to state taxation. Shell claims that section 1333(a)(3) of the Outer Continental Shelf Lands Act supports this contention. Section 1333(a)(3) reads:

> The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.

We find that Shell's reliance on section 1333(a)(3) is misplaced. Although section 1333(a)(3) prevents states form claiming an interest in or jurisdiction over the revenues derived from OCS natural resources, the language of this

subsection when read in conjunction with the rest of section 1333(a) simply constitutes a limitation of state authority over the OCS area and does not seem intended to address income derived outside the OCS.[2]

[1] Income is normally taxed when realized. Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75 (1940); § 220.02(4)(a), Fla.Stat. (Supp.1972). Realization occurs when a taxpayer receives actual economic gain from the disposition of property. Helvering, 311 U.S. at 115, 61 S.Ct. at 146; S.R.G. Corp. v. Department of Revenue, 365

---

2 If this were not so, we would be at a loss to understand why the United States Supreme Court, in Maryland v. Louisiana, 451 U.S. 725, 101 S.Ct. 2114, 68 L.Ed.2d 576 (1981), tested the validity of Louisiana's "first use" tax by examining its effect on interstate commerce rather than by scrutinizing the viability of taxing gas derived from the outer continental shelf.

So.2d 687 (Fla.1978); Heftler Construction Co. v. Florida Department of Revenue, 438 So.2d 139 (Fla. 3d DCA 1983), review denied, 449 So.2d 264 (Fla.1984). In the case at bar, this realization occurred at the time of sale. Clearly, no realization of income occurred at the wellhead, despite Shell's assignment of an artificial wellhead price to the oil, because Shell received no actual economic gain from any "sale, exchange, or other disposition of property" at that point. § 220.02(4)(a). Rather, realization occurred at the time Shell sold the oil in the States because only at that time did Shell derive any actual economic gain.

[2] Shell insists that all OCS production should be excepted from the general rule that the time of realization is the proper time for judging the

taxable nature of income. Yet the cases Shell cites for the proposition that the instant transactions lie beyond the taxable reach of DOR are distinguishable. In both Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico, 458 U.S. 832, 102 S.Ct. 3394, 73 L.Ed.2d 1174 (1982), and James v. Dravco Construction Co., 302 U.S. 134, 58 S.Ct. 208, 82 L.Ed. 155 (1937), the income was realized beyond the respective state's taxing jurisdiction. In the instant case Shell realized the income within the fifty states and both parties agree that Florida can generally levy an apportioned tax on income derived within any of the fifty states. Thus Shell has offered no relevant authority for its claim that OCS production sold in the states should be an exception to the norm. As the district court pointed out, taking Shell's argument to its

logical conclusion, no state could impose any kind of tax on any final product which eventually might be derived from OCS production. We join the district court in finding that Congress never intended such a sweeping result when it passed the Outer Continental Shelf Lands Act. Therefore, we approve the district court's opinion as it relates to the certified question, which we answer in the negative.

[3] We find, however, that the district court erred in ruling that expensed IDCs should be added back into Shell's asset base when calculating the property factor of the apportionment formula. IDCs are not inherently capital in nature. Under federal law, Shell had the option of either capitalizing or expensing its IDCs. IRC § 263(a) & (c) (1954); Treas.Reg. 1.612-4 (1965). Shell elected to expense them for

federal income tax purposes, thereby deducting the IDCs from its taxable income base. Section 220.42(1), Florida Statutes (Supp.1972), requires that a taxpayer's method of accounting for purposes of the Florida Income Tax Code be the same as the taxpayer's method of accounting used for federal income tax purposes. Accordingly, Shell expensed its IDCs on its Florida income tax return.

IDCs occupy a special tax category, offering an incentive to oil and gas exploration and production. Exxon Corp. v. United States, 37 A.F.T.R.2d (P-H) 76-730, 547 F.2d 548 (Ct.Cl.1976); Atlantic Richfield Co. v. Department of Revenue, 9 Or.T.R. 451 (1984). Care must be taken, however, not to extend the obvious benefits of this special treatment beyond its intended boundaries. Exxon Corp., 37 A.F.T.R.2d (P-H)

at 76-736, 547 F.2d 548; Atlantic Richfield Co., 9 Or.T.R. at 453-54.

Under the Uniform Division of Income for State Purposes Act (UDITPA), which Florida has adopted, a given state determines its apportioned share of a multistate corporation's taxable income on the basis of a three-factor formula composed of sales, payroll, and property. § 214.70-.73 & 220.15(4), Fla. Stat. (1973). Although Shell expensed its IDCs from its taxable income base, it added the IDCs back into its asset base for purposes of calculating the property factor. Federal tax regulations expressly provide, however, that, in the case of oil and gas wells, no adjustment to basis shall be made with respect to IDCs allowable as a deduction in computing net or taxable income. Tres. Reg. § 1.1016-2(a) (1957). Moreover, under Florida law, property is to

be valued at "original cost" for purposes of inclusion in the property factor of the apportionment formula. Fla. Admin.Code Rule 12C-1.15(4)(b)(5). Rule 12C-1.15(4)(b)(5) defines "original cost" as the basis of the property for federal income tax purposes at the time of acquisition plus any subsequent capital additions or improvements and less any partial dispositions by sale, exchange, or abandonment. Accordingly, because Shell elected to expense its IDCs and thereby voluntarily subjected itself to the restrictions of treasury regulation section 1.1016-2(a), the Florida Administrative Code bound Shell to the same election for Florida purposes. This ruling is consistent with the results reached by the vast majority of other states operating under the UDITPA. Atlantic Richfield Co., 9 Or.T.R. at 455; Appeal of Pauley

Petroleum, Inc., [1982] California Tax Reports (CCH) § 400-101. In addition to ignoring rule 12C-1.15(4)(b)(5), the district court erred in disregarding the clear mandate of section 220.42(1), Florida Statutes (Supp.1972), which requires a taxpayer's accounting method for Florida tax purposes be the same as the method used for federal income Tax purposes. Although DOR failed to bring this statute to the trial court's attention, a reviewing court must follow controlling statutes no matter what omissions may have occurred at trial. Bendenbaugh v. Adams, 88 So.2d 765 (Fla. 1956); City of Lakeland v. Select Tenures, Inc., 129 Fla. 338, 176 So. 274 (1937); Barnett Bank v. Jacksonville National Bank, 457 So.2d 535 (Fla. 1st DCA 1984); § 90.201, Fla.Stat. (1983).

Accordingly, we answer the certified question in the negative and

approve the opinion of the district court as it relates to the taxation of OCS production income realized within the fifty states. We quash, however, the opinion of the district court as it relates to the inclusion of IDCs in the property factor of Florida's tax apportionment formula and remand for proceedings consistant with this opinion.

It is so ordered.

ADKINS, OVERTON, EHRLICH and BARKETT, JJ., concur.

BOYD, C.J., dissents with an opinion, in which SHAW, J., concurs.

BOYD, Chief Justice, dissenting.

Because I find that Florida's corporate income tax law directly conflicts with federal law specifically prohibiting the application of state taxes to the outer Continental Shelf, I must respectfully dissent from the majority

opinion. I conclude that Congress intended to limit state taxation power over revenues generated from drilling on the outer Continental Shelf regardless of where the sale of the oil takes place and that this limitation, by virtue of the Supremacy Clause, article VI, clause 2, of the United States Constitution, takes precedence over the State of Florida's interest in taxing the income derived from such revenues.

Article VI, clause 2, of the United States Constitution provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution of Laws of any State to the Contrary notwithstanding.

This provision standing alone has been interpreted as a limitation on the power of the states to tax the United States

Government. However, it also recognizes that Congress can expand the immunity from state taxation beyond this constitutional limitation. See United States v. New Mexico, 455 U.S. 720, 102 S.Ct. 1373, 71 L.Ed.2d 580 (1982); see also, Arizona Public Service Commission v. Snead, 441 U.S. 141, 94 S.Ct. 1629, 60 L.Ed.2d 106 (1979). Whether a federal law preempts a state law depends on whether the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Maryland v. Louisiana, 451 U.S. 725, 747, 101 S.Ct. 2114, 2129, 68 L.Ed.2d 576 (1981), quoting Hines v. Davidowitz, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed.2d 581 (1941). Preemption analysis should not be controlled by mechanical or absolute conceptions, but rather should require a particularized examination of the rele-

vant state and federal interests. See Ramah Navajo School Board v. Bureau of Revenue of New Mexico, 458 U.S. 832, 102 S.Ct. 3394, 73 L.Ed.2d 1174 (1982).

Hence an analysis of this case must begin with the purposes and objectives of the Outer Continental Shelf Lands Act, ch. 345, § 2, 67 Stat. 462 (1953) (codified as amended at 43 U.S.C. §§ 1331 et. seq. (1982)), which extended the Constitution and laws of the United States to the Outer Continental Shelf; i.e., that property located beyond the three mile limit of state jurisdiction established by the Submerged Lands Act, ch. 65, Title I, § 2, 67 Stat. 29 (1953) (codified at 43 U.S.C. §§ 1301 et seq. (1982)). Congress originally declared that the policy of the United States was that:

> (a) the subsoil and seabed of the outer Continental Shelf appertain to the United States and are subject to its jurisdiction, con-

trol, and power of disposition as provided in this subchapter;

(b) this subchapter shall be construed in such a manner that the character of the waters above the outer Continental Shelf as high seas and the right to navigation and fishing therein shall not be affected.

43 U.S.C. § 1332. Later Congress amended this section to renumber subsections (a) and (b) to (1) and (2) and to add the following subsections (3) thru (6):

(3) the outer Continental Shelf is a vital national resource reserve held by the Federal Government for the public, which should be made available for expeditious and orderly development, subject to environmental safeguards, in a manner which is consistent with the maintenance of competition and other national needs;

(4) since exploration, development, and production of the minerals of the outer Continental Shelf will have significant impacts on coastal and non-coastal areas of the coastal States, and on other affected States, and, in recognition of the national interest in the effective management of the marine, coastal, and human environments -

(A) such States and their affected local governments may require assistance in protecting their coastal zones and other affected areas from any temporary or permanent adverse effects of such impacts; and

(B) such States, and through such States, affected local governments, are entitled to an opportunity to participate, to the extent consistent with the national interest, in the policy and planning decisions made by the Federal Government relating to exploration for, and development and production of, minerals of the outer Continental Shelf;

(5) the rights and responsibilities of all States and, where appropriate, local governments, to preserve and protect their marine, human, and coastal environments through such means as regulation of land, air, and water uses, of safety, and of related development and activity should be considered and recognized; and

(6) operations in the outer Continental Shelf should be conducted in a safe manner by well-trained personnel using technology, precautions, and techniques sufficient to prevent or minimize the likelihood of blowouts, loss of well control, fires, spillages, physical obstruction to other users of the waters or subsoil and seabed, or

> other occurrences which may cause damage to the environment or to property, or endanger life or health.

Act of Sept. 18, 1978, Pub.L. 95-372, Title II, § 202, 92 Stat 634 (1978).

Section 1333(a)(1) of the Outer Continental Shelf Lands Act extends federal jurisdiction to all artificial islands and fixed structures erected on the Outer Continental Shelf "to the same extent as if the Outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State." Furthermore Congress also provided:

> (2) ... State taxation laws shall not apply to the outer Continental Shelf.
>
> (3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.

43 U.S.C. § 1333.

Section 1334 sets forth the procedures for administering the leasing of the outer Continental Shelf. Under this section the Secretary of Interior is responsible for promulgating rules and regulations determined to be "necessary and proper in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf, and the protection of correlative rights therein." This section was amended in 1978 to also provide that the lessee "shall produce any oil or gas, or both, obtained pursuant to an approved development and production plan." 43 U.S.C. § 1334(g)(1)

Section 1337 sets forth the procedures for the bidding of leases on the outer Continental Shelf. Subsection (a)(3) presently authorizes the Secretary of Interior to "promote increased production on the lease area, through

direct, secondary, or tertiary recovery means, reduce or eliminate any royalty or net profit share set forth in the lease for such area." Section 1344 requires the Secretary of Interior to

> prepare and periodically revise, and maintain an oil and gas leasing program to implement the policies of this subchapter. The leasing program shall consist of a schedule of proposed lease sales indicating, as precisely as possible, the size, timing, and location of leasing activity which he determines will best meet national energy needs for the five-year period following its approval or reapproval.

As can be seen from the above quoted provisions, the major purpose of the outer Continental Shelf Lands Act was to give the federal government exclusive control over the development and production of the mineral resources lying outside the three mile limit. As the United States Supreme Court noted:

> The legislative history confirms that the purpose of OCSLA was "to assert the exclusive jurisdiction and control of the Federal Government of the United States over the

seabed and subsoil of the outer Continental Shelf, and to provide for the development of its vast mineral resources." S.Rep. No. 411, 83d Cong., 1st Sess., 2 (1953) (hereinafter 1953 S.Rep.). Congress enacted OCSLA in the wake of decisions by this Court that the Federal Government enjoyed sovereignty and ownership of the seabed and subsoil of the Outer Continental Shelf to the exclusion of adjacent States. See United States v. Texas, 339 U.S. 707 [70 S.Ct. 918, 94 L.Ed. 1221] (1950); United States v. Louisiana, 339 U.S. 699 [70 S.Ct. 914, 94 L.Ed. 1226] (1950). See also United States v. California, 332 U.S. 19 [67 S.Ct. 1658, 91 L.Ed. 1889] (1947). See generally, Maryland v. Louisiana, 451 U.S. 725, 730 [101 S.Ct. 2114, 2120, 68 L.Ed.2d 576] (1981). Congress chose to retain exclusive federal control of the administration of the Shelf because it underlay the high seas and the assertion of sovereignty there implicated the foreign policies of the Nation. See 1953 S.Rep., at 6. Much of OCSLA provides a federal framework for the granting of leases for exploration and extraction of minerals from the submerged lands of the Shelf. See 43 U.S.C. §§ 1334-1343.

Gulf Offshore Co. v. Mobil Oil Corp., 453 U.S. 473, 480 n. 7, 101 S.Ct. 2870, 2876 n.7, 69 L.Ed.2d 784 (1981).

It is a matter of settled law that no state has jurisdiction to tax in an area of exclusive federal jurisdiction located within a state. Ramah Navajo School Board v. Bureau of Revenue of New Mexico, supra; James v. Dravo, 302 U.S. 134, 58 S.Ct. 208, 82 L.Ed. 155 (1937). Since Congress extended federal jurisdiction to the outer Continental Shelf "to the same extent" as if it were an area of exclusive federal jurisdiction within a state, this body of settled law applies with equal force to the outer Continental Shelf and effectively prohibits the imposition of any state tax on revenues derived therefrom.

The lack of jurisdiction in a state to tax in areas of exclusive federal jurisdiction applies not only to direct taxes but to indirect taxes as well. In Ramah, the Supreme Court held that

federal law preempts a state Tax imposed on the gross receipts a non-Indian construction company received for the construction of a school on a reservation. The Court concluded that the federal objectives of educating Indian children outweighed the state's objective of raising revenue. In James v. Dravo, the United States Supreme Court was faced with the question of whether "annual privilege taxes" measured by profits from "business and other activities" could be imposed by West Virginia on a contractor working on government-owned land. The Supreme Court stated that this depended upon "whether the United States has acquired exclusive jurisdiction over the respective sites. Wherever the United States has such jurisdiction the state would have no authority to lay the tax." Id. at 140, 58 S.Ct. at 212.

With respect to the outer Continental Shelf, the United States Supreme Court has expressly stated that a state "has no valid interest in imposing a severance tax on federal OCS land." Maryland v. Louisiana, 451 U.S. at 752 n. 26, 101 S.Ct. at 2132 n. 26. In that case several States filed an original action with the Supreme Court challenging the constitutionality of Louisiana's First-Use Tax. They claimed, among other things, that the tax was in direct conflict with the Outer Continental Shelf Lands Act. Louisiana attempted to "justify the tax as a means of alleviating the alleged discrimination against Louisiana gas caused by the fact that Louisiana gas must pay the state severance tax while OCS gas does not." Id. In response to this argument the Supreme Court noted that

> if correcting the claimed imbalance were the sole justification asserted for the First-Use tax, there would be grave doubt about the validity of the Tax. The proper fee or charge for drilling for gas on the OCS is a determination which is solely within the province of the Federal Government. Even if the United States were to decide to open up development to all comers at no charge in order to spur development of natural gas, Louisiana would have no interest in overriding that decision by imposing a tax to equalize the cost of local production with that on the federal OCS area. Permitting the States to exercise such power would adversely affect the price which the Government could command from private developers in their bid price. As clearly required by the OCS Act, Louisiana's sovereign interest in the development of offshore mineral interests stops at its 3-mile border.

Id.

The reason why the Supreme Court did not specifically decide to hold that Louisiana's First-Use tax was in direct conflict with the Outer Continental Shelf Lands Act was because Louisiana also argued that certain environmental interests were being served by the tax. If true, then the tax would not be

in direct conflict with the OCSLA because Congress adopted specific provisions allowing the states to retain control over the environmental impact offshore drilling may have in their jurisdictions. Since the First-Use tax applied to oil obtained from sources other than the outer Continental Shelf, resolution of this issue would not have been dispositive of the case and was therefore unnecessary to decide. Thus judicial conservatism, not judicial imprimatur as the majority opinion suggests, was the reason why the Supreme Court did not test the validity of this tax by examining its effect on the OCSLA. From this discussion, it is clear that the Supreme Court intends that the appropriate process for analyzing the preemption question is to examine the relative interests of the state and federal government, and not to

decide the matter by using a mechanical or absolute concept as was done in the majority opinion.

The next step in this analysis is to determine whether Florida's Corporate Income Tax Code, chapter 220, Florida Statutes (1985), conflicts with federal governments regulating the production of oil on the outer Continental Shelf. Florida's corporate income tax is a tax on income "at such time as such income is realized for federal income tax purposes." § 220.02(4)(a), Fla.Stat. (1985). The amount of income attributed to being earned in Florida is calculated by the apportionment formula found in chapter 214, Part IV, Florida Statutes (1985). Simply stated, this formula is the sum of three fractions. The numerators of these fractions are the corporation's real and tangible personal property, payroll, and sales within

Florida and the respective denominators are the total amounts of the corporation's real and tangible personal property, payroll, and sales in the United States, its territories, and any foreign country.

It is clear that this tax can have a great impact upon the production of oil on the outer Continental Shelf. The higher the tax, the less incentive for companies to explore and produce oil. This could be in direct contravention to the desires of the federal government and could interfere with its sole responsibility to oversee the production and preservation of natural resources contained in the outer Continental Shelf. The impact of this tax does not depend on where the sale of the oil takes place.

It is also clear that the tax is not imposed to further any conservation

or environmental goals. For that reason it does not fall within the range of authority Congress specifically delegated to the States under the OCSLA.

Since this tax directly conflicts with the OCSLA, the amount of income generated by the production of oil and gas on the outer Continental Shelf should be excluded from the net income subject to Florida's corporate income tax pursuant to section 220.02(5), Florida Statutes (1985). The proper amount to be excluded is the fair market value of the oil and gas at the well head. This is a well established and commonly accepted practice in the industry for determining the value of oil and gas, and is in fact, the method used by the United States government itself in determining the price it pays for oil and gas produced on the outer Continental Shelf. See 43 U.S.C. § 1353(2).

In every other respect I agree with the majority opinion. But because of the reasons discussed above, I feel compelled to dissent. I would therefore reverse the decision of the district court of appeal and remand this case to the trial court for further proceedings consistent with this dissent.

SHAW, J., concurs.

Appendix 2

SHELL OIL CO.

v.

DEPT OF REVENUE

Cite as 461 So.2d 959

(Fla.App. 1 Dist. 1984)

SHELL OIL COMPANY,

Appellant,

v.

DEPARTMENT OF REVENUE,

Appellee.

No. AS-159.

DISTRICT COURT OF APPEAL OF FLORIDA,

First District.

April 3, 1984.

Rehearing Denied Nov. 6, 1984.

The Circuit Court, Leon County, Ben C. Willis, J., entered a summary judgment subjecting income derived from the sale of oil to the corporate income tax,

and the oil company appealed and the Department of Revenue cross-appealed. The District Court of Appeal, Smith J., held that: (1) income which oil company derived from sale in the United States of oil from wells located on the outer continental shelf during the years in question was subject to corporate income tax, but question was of great public importance and would be certified, and (2) oil company was entitled to include drilling and development costs in the property factor in the apportionment formula in determining the amount of corporate income tax.

Affirmed.

Wentworth, J., concurred and dissented with opinion on rehearing.

1. Taxation 1002

Income which oil company derived from sale in the United States of oil from wells located on the outer continental shelf during the years in question was subject to corporate income tax. Outer Continental Shelf Lands Act, § 4(a)(2)(A), as amended, 43 U.S.C.A. § 1333(a)(2)(A); West's F.S.A. § 214.71.

2. Taxation 1002

Assessing corporate income taxes on income derived from the sale in the United States of oil extracted from the outer continental shelf was not violative of the Outer Continental Shelf Lands Act. Outer Continental Shelf Lands Act, § 4(a)(2)(A), as amended, 43 U.S.C.A. § 1333(a)(2)(A); West's F.S.A. § 214.71.

3. Taxation 1005

Outer continental shelf property and payroll did not come within the parameters of "everywhere" in the statute governing the corporate income tax and thus could not be included in the denominators of the property and payroll factors even though the sales in the United States of oil derived from the outer continental shelf occurred in the various states of the United States defined as "everywhere" in the tax statute. Outer Continental Shelf Lands Act, § 3(a), as amended, 43 U.S.C.A. § 1332(a); West's F.S.A. §§ 220.15(3), 214.71(1).

4. Taxation 1005

A direct correlation was not required between the income from the sales of oil subject to the corporate income tax and the property, payroll,

and sales included in the apportionment formula. Outer Continental Shelf Lands Act, § 3(a), as amended, 43 U.S.C.A. § 1332(a); West's F.S.A. §§ 220.15(3), 214.71(1).

5. Taxation 1005

Oil company was entitled to include drilling and development costs in the property factor in the apportionment formula in determining the amount of corporate income tax it owed on the sales in the United States of oil derived from the outer continental shelf. Outer Continental Shelf Lands Act, § 3(a), as amended, 43 U.S.C.A. § 1332(a); West's F.S.A. §§ 220.15(3), 214.71(1).

On Rehearing

6. Taxation 1078, 1087

Statute requiring a taxpayers' method of accounting to be the same as

its method of accounting for federal income tax purposes may have precluded oil company from classifying intangible drilling and development costs as expenses in its federal income tax returns, thus effecting a reduction in tax income for the year in which the expenditures were made, but since the statute was not cited in the taxpayer's brief or its oral argument, issue could not be raised for the first time on appeal. West's F.S.A. §§ 120.54(7), 220.42.(1).

Robert B. Glenn, Jr., of Glenn, Rasmussen, Fogarty & Merryday, Tampa, Elizabeth C. Burton, Houston, Tex., for appellant.

Jim Smith, Atty. Gen., Thomas L. Barnhart, Asst. Atty. Gen., Tallahassee, for appellee.

SMITH, Judge.

Shell appeals from the trial court's final summary judgment holding, among other things, that the Department's treatment of Shell's income derived from the sale in the United States of oil from wells located in the outer continental shelf during the years from 1972 to 1975 does not violate the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333(a)(2)A. The Department cross-appeals the trial court's finding that Shell may include all of the original costs" of its oil and gas wells, in particular its intangible drilling and development costs, in the property factor of the apportionment formula for determining its Florida corporate taxes, Section 214.71, Florida Statutes (1972). We affirm the final summary judgment in its entirety.

[1,2] Shell's primary issue is apparently one of first impression in this state and elsewhere, namely, whether 43 U.S.C. § 1333(a)(2)A,[1] infra, prohibits Florida from taxing its income

---

1. § 1333. Laws and regulations governing lands

(a) Constitution and United States laws; laws of adjacent States; publication of projected State lines; international boundary disputes; restriction on State taxation and jurisdiction

* * * * * *

(2)(a) To the extent that they are applicable and not inconsistent with this subchapter or with Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the

continued next page

from the sale in the United States of oil extracted from its outer continental shelf wells. We reject Shell's position that it does, for all of the oil from these wells was brought into the United States, refined in the United States, and then sold in the United States. Florida is thus assessing corporate income taxes on income derived from sales occurring in the United States, so the significant event for purposes of that tax is the sale of the oil, not the removal of the oil from the outer continental shelf. Taking Shell's

---

1. continued

> Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf. (emphasis supplied)

argument to its logical conclusion, a state could not impose any tax, such as a sales tax, for any product it derives from its outer continental shelf wells. We cannot agree that an interpretation having such sweeping consequences was ever intended by the Congress, and we therefore reject it.

As a corollary argument Shell contends that Section 220.02(5), Florida Statutes,[2] requires the complete exclusion of income derived from the outer continental shelf oil because

---

2. 220.02 Legislative intent. -
* * * * * *
(5) It is the intent of the legislature that if there is included in any taxpayer's net income subject to tax under this code any item or items of income which are determined to be improperly so included because of a conflict with any federal statute, the Constitution of the United States, or the state

continued next page

including that income would cause a conflict with a federal statute, in this case the OCSLA. We view this contention as nothing more than a restatement of Shell's first issue discussed above and therefore reject it.

Shell also argues that there should be a direct correlation between the income subject to the Florida corporate tax and the property, payroll and sales included in the apportionment formula, citing Heftler Construction v. Department of Revenue, 334 So.2d 129 (Fla. 3rd DCA 1976). Before analyzing this issue,

---

2. continued

constitution, all such items of income shall be excluded from the net incomes of all taxpayers subject to the tax under this code, but all other provisions of this chapter, and their application, shall not be invalidated or in any way impaired by such required exclusion of an item or items of income.

however, a brief description of Florida's method of apportioning corporate taxes may be useful.

The income of a business, such as Shell, operating both within and without Florida, is apportioned to Florida in accordance with a three-factor formula. While the normal three-factor formula is the arithmetic average of three factors, a corporation's property, payroll, and sales, Florida's formula is double-weighted in favor of the sales factor. Each apportionment factor is therefore the ratio of Florida business activity (property, payroll, and sales) to "everywhere" business activity (property, payroll, and sales). Sections 214.71, and 220.15, Florida Statutes. "Everywhere" means "in all states of the United States, the District of Columbia, or any political subdivision of the

foregoing." Section 220.15(3), Florida Statutes.

Shell excluded its outer continental shelf income from income apportionable to Florida by subtracting from its adjusted federal taxable income the wellhead fair market value of the oil recovered at its outer continental shelf drilling installations, less related expenses. It also excluded outer continental shelf real and tangible personal property from the denominator of the property factor, outer continental shelf payroll from the denominator of the payroll factor, and outer continental shelf sales from the denominator of the sales factor of the apportionment formula. It now urges, as it did before the trial court, that this process is justified by the Heftler decision. Shell further argues that the

Department's inclusion of sales of oil derived from the outer continental shelf wells in the denominator of sales factor is inconsistent with its exclusion of outer continental shelf property and payroll from the denominators of the property and payroll factors.

[3] Addressing the latter contention first, we find that the Department properly computed Shell's sales, property, and payroll "everywhere" in the denominators of the sales, property, and payroll factors. "Everywhere" is defined by Section 220.15(3) to include "all states of the United States, the District of Columbia, or political subdivision of the foregoing." The outer continental shelf, however, is not a state of the United States, the District of Columbia, or political division thereof. Rather, it is a part of the

United States, 43 U.S.C. § 1332(a), Internal Revenue Code, § 638, so while the sales in the United States of oil derived from the outer continental shelf wells occurred in the various states of the United States defined as "everywhere," outer continental shelf property and payroll do not come within the parameters of "everywhere," Section 220.15(3), and thus cannot be included in the denominators of the property and payroll factors.

[4] We likewise reject Shell's contention that Heftler mandates a direct correlation between the income subject to tax in Florida and the property, payroll, and sales included in the apportionment formula. Simply stated, the profits and losses involved in Heftler were earned in Puerto Rico and were therefore considered foreign,

while the income in Shell's case was realized totally from sales of oil in the various states of the United States.

[5] We also must reject the Department's argument on cross-appeal to the effect that Shell should not be allowed to include drilling and development costs in the property factor in the apportionment formula. Property, both real and tangible, is to be valued at original cost, Section 214.71(1), and the Department has defined "original cost" as follows:

> As a general rule "original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange or abandonment, etc.

Florida Administrative Code Rule 12C-1.15(4)(b)5. Relying on this rule, the

Department urges that Shell's intangible drilling and development expenditures have no recognizable cost or other basis sufficient to permit the inclusion of those costs in the property factor because they have been deducted by Shell for federal income tax purposes in accordance with Section 263(c) of the Internal Revenue Code. We note that when Shell did so, according to the federal rule, it also forfeited any right to include these costs in the federal tax basis of the property. However, while the Internal Revenue Code may so treat these costs, there is nothing in Rule 12C-1.15(4)(b)5 that mandates how these capital additions for improvements are to be treated, for Florida tax purposes, because of a taxpayer's election, as permitted under Section 263(c) of the Internal Revenue Code, to either deduct these intangible

drilling costs from his gross income or to capitalize those costs in following years. Since Shell's capitalization of these costs is permissible "for federal income tax purposes," Shell's procedure conforms to the Department's rule.

AFFIRMED.

WENTWORTH and JOANOS, JJ., concur.

ON MOTION FOR REHEARING

Shell petitions this court for rehearing; the Department on cross-appeal petitions for rehearing and/or clarification. We find that Shell's petition fails to convince us that our original opinion misconstrued or misapplied the law or the facts involved in Shell's points on appeal. Accordingly, Shell's petition for rehearing is denied.

We also deny cross-appellant Department of Revenue's motion for rehearing and clarification. The motion is

directed to that portion of our decision affirming the trial court's final summary judgment prohibiting the department from excluding Shell's intangible drilling and development costs (IDC's) from Shell's property factor in the department's apportionment formula.

[6] The department now urges that this court overlooked Section 220.42(1), Florida Statutes. That section provides, in pertinent part:

> (1) For purposes of this code, a taxpayer's method of accounting shall be the same as such taxpayer's method of accounting for federal income tax purposes . . . . (e.s.)

This provision, the department argues, precludes Shell from classifying IDC's as expenses in its federal income tax returns (thus effecting a reduction in taxable income for the year in which the expenditures are made), while at the same time classifying them as capital

assets (treated as a part of the cost of acquisition of the oil well), for Florida income tax purposes. Shell's unrefuted affidavits established that Shell, for years, has maintained corporate financial records treating these IDC's as capital assets, thus properly treatable, under Shell's view, as a part of the "original cost" as this terminology is used in Rule 12C-1.15(4)(b)5, Florida Administrative Code, both in the numerator and denominator of the apportionment formula.

There is merit in the department's position that the statute (Section 220.42(1)) would indicate that IDC's should be treated the same in the apportionment formula as in Shell's federal income tax returns. We may speculate that had this statute been urged in the court below, in support of the depart-

ment's interpretation of its rule, the trial judge's decision might well have been favorable to the department on this issue. However, so far as we have been able to determine from the record, the statute was never mentioned below. Neither was the statute cited in the department's brief in this court, nor in oral argument. Furthermore, the issue as presented in this court, as framed by the department, was "[W]hether the definition of 'original cost' provided in Rule 12C-1.15(4)(b)5, F.A.C., is a valid exercise of delegated legislative authority." We find that the rule itself contains no reference to Section 220.42(1), although under the rule-making provisions, Section 120.54(7), Florida Statutes, each rule is required to contain a reference to "the section or subsection of the Florida Statutes or Laws of Florida being implemented,

interpreted, or made specific." The basic issue in this case, as indicated in our original opinion, was whether the procedure followed by Shell conformed to the rule, or was prohibited by it. The trial court, after consideration of the pleadings and the evidence produced on Shell's motion for summary judgment, determined this issue in favor of the taxpayer. This court affirmed that ruling, which we find to be consistent with the rule governing construction of taxing enactments in favor of the taxpayer. See, Department of Revenue v. Brookwood Associates, Ltd., 324 So.2d 184 (Fla. 1st DCA 1975); Harris Corporation v. Department of Revenue, 409 So.2d 91, 93 (Fla. 1st DCA 1982) (Ervin, J. specially concurring).

Our disposition of the department's motion for rehearing is mandated by the

rule that authorities not cited and issues not raised in the brief or on oral argument cannot be raised for the first time on motion for rehearing. Price Wise Buying Group v. Nuzum, 343 So.2d 115 (Fla. 1st DCA 1977); Cartee v. Florida Department of Health and Rehabilitative Services, 354 So.2d 81 (Fla. 1st DCA 1977). The department's motion for rehearing is therefore denied.

One final matter requires our attention. Shell has requested that we certify the question of whether the department is prohibited by 43 U.S.C. § 1333(a)(2)(A) (1981), from levying a corporate income tax on income derived from the outer continental shelf. Since this question is one of first impression, and is vitally important to the state's ability to raise revenue via corporate income taxation, we grant

Shell's request, and certify the following question as being of great public importance, pursuant to Florida Rules of Appellate Procedure 9.030(a)(2)(A)(v):

> WHETHER THE STATE OF FLORIDA IS PROHIBITED BY 43 U.S.C. § 1333(a)(2)(A) FROM IMPOSING A TAX UPON INCOME DERIVED FROM THE SALE IN THE UNITED STATES OF OIL EXTRACTED FROM THE OUTER CONTINENTAL SHELF?

Motion for rehearing DENIED, question certified.

JOANOS, J., concurs.

WENTWORTH, J., concurs and dissents with written opinion.

WENTWORTH, Judge, concurring and dissenting on rehearing.

I agree with denial of appellant's motion for rehearing but would grant cross-appellant's motion and reinstate the Department's determination of Shell's property factor in the appor-

tionment formula. Section 220.42(1), Florida Statutes, requires that for Florida income tax purposes Shell's "method of accounting shall be the same as such taxpayer's method of accounting for federal income tax purposes." I would conclude upon reconsideration that this statutory language dictates a construction of Rule 12C-1.15(4)(b)5, F.A.R., to require that Shell's method of accounting for federal income tax purposes, by which it deducted intangible drilling costs from gross income and precluded capitalization thereafter, determines the method of accounting by which the property factor shall be computed in the apportionment formula under the Florida code. I would reverse on cross appeal because I review the action of the trial court as if it had complied, as we should, with the mandate for judicial notice of pertinent Florida

statutes in resolving this litigation. § 90.201, Florida Statutes; Barnett Bank of Jacksonville v. Jacksonville National Bank, 457 So.2d 535 (Fla. 1st DCA 1984).[1] The context of the present case is peculiarly unsuited to the application of a waiver doctrine against administrators in a way which subverts the terms of a statute merely because a rule, which functionally if not nominally implements all pertinent statutes, may not have been defended with perfection.

---

1. Although [the statute] was not called to the trial court's attention, nevertheless it must be followed by this court because the statute controls the matter before us. Bedenbaugh v. Adams, 88 So.2d 765 (Fla. 1956).

Appendix 3

CASE NO. 80-987

IN THE CIRCUIT COURT FOR

LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff.

vs.

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA.

Defendant.

RECORDED

MAR 24 AT 949 AM - 83

PAUL F. HARTSFIELD

CLERK OF CIRCUIT COURT

/

FINAL JUDGMENT

This case involves Florida corporate income taxes for Shell Oil Company ("Shell") for the years 1972 through 1975. Both Shell and the Department of Revenue of the State of Florida (the "Department") moved for summary judgment, and the court has previously entered two orders, both dated February

3, 1983, ruling on these motions. After deciding the motions for summary judgment, only one issue remained for determination, i.e., whether Shell's income derived from its production business on the Outer Continental Shelf ("OCS") should be apportioned by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula") or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in the denominators of the Apportionment Formula. Although this issue was originally part of Shell's motion for summary judgment, Shell withdrew this issue prior to the summary judgment hearing. The court has denied the Department's motion for summary judgment on this issue. Shell has now filed a motion to amend to delete its prayer for

relief relating to this withdrawn issue, and upon ruling on the motion to amend, all issues will have been decided on summary judgment. Therefore, it is

ORDERED AND ADJUDGED as follows:

1. Shell's Motion to Amend to delete its prayer for relief relating to the withdrawn issue is hereby granted.

2. The court adopts its orders dated February 3, 1983, on the motions for summary judgment filed by Shell and the Department as follows:

(a) Shell's Motion for Summary Judgment on the first issue raised by Shell, i.e, whether the treatment by the Department of Shell's income derived from its production business on the OCS violated the Outer Continental Lands Act, 43 U.S.C. §1333(a)(2) is denied, and the Department's Motion for Summary Judgment on this issue is granted.

(b) Shell's Motion for Summary Judgment on the issue of whether the Department unlawfully refused to allow Shell to include all of its original costs of its oil and gas wells, particularly its intangible drilling and development costs, in the property factor of the Apportionment Formula is granted, and the Department's Motion for Summary Judgment on this issue is denied.

(c) The Department having admitted the mechanical error in the calculation of the property factor of the Apportionment Formula, causing an overstatement of Shell's tax liability by $5,504, Shell's motion on this issue is granted.

(d) Shell's Motion for Summary Judgment on the issue of whether a portion of the Department's assessment for 1972 is barred by the applicable statute of limitations is denied, and the

Department's Motion for Summary Judgment on this issue is granted.

3. As a result of the foregoing rulings, the Department has overstated Shell's tax liability by $5,504 because of a mathematical error in the calculation of the property factor of the Apportionment Formula contained in §214.71, Florida Statutes. The Department further overstated Shell's income taxes by $24,230.00 because of its failure to allow Shell to include all of its original costs of oil and gas wells, particularly intangible drilling and development costs in the property factor of the Apportionment Formula.

DONE AND ORDERED at Tallahassee, Florida, this 24th day of March, 1983.

Ben C. Willis, Circuit Judge

Copies furnished to:

Robert B. Glenn, Jr.

Thomas L. Barnhart

Appendix 4

IN THE SUPREME COURT OF FLORIDA

MONDAY, NOVEMBER 24, 1986

CASE NO. 66,240

SHELL OIL COMPANY,

Petitioner,

vs.

DEPARTMENT OF REVENUE,

Respondent

CASE NO. 66,254

DEPARTMENT OF REVENUE,

Petitioner

vs.

SHELL OIL COMPANY,

Respondent.

On consideration of the motion for rehearing filed by attorneys for Shell Oil Company, and response thereto, it is ordered that said motion be and the same is hereby denied.

The motion to strike and expunge record is granted and the Motion for Order Compelling Compliance with Court Decision along with the documents attached to said motion are hereby stricken.

The Request for Further Oral Argument filed by attorneys for Shell Oil Company is hereby denied.

The Motion for Court to Take Judicial Notice filed by attorneys for Department of Revenue on August 26, 1986, is hereby denied.

The Motion for Leave to Brief Case Noticed in this Action filed by attorneys for Department of Revenue is hereby denied.

The Motion for Court to Take Judicial Notice filed by attorneys for Department of Revenue on June 25, 1986, is hereby denied.

cc: Hon. Raymond E. Rhodes, Clerk
Hon. Paul F. Hartsfield, Clerk
Hon. Donald O. Hartwell, Chief Judge

Arthur J. England, Jr., Esquire
William D. Peltz, Esquire
Elizabeth C. Burton, Esquire
Joseph C. Mellichamp, III, Esquire
Sharon A. Zahner, Esquire

SEAL
Clerk of Supreme Court

Appendix 5

IN THE SUPREME COURT OF

THE STATE OF FLORIDA

Case Nos. 66,240 & 66,254

Shell Oil Company,

Appellant,

vs.

Department Of Revenue State Of Florida,

Appellee.

STAMPED "FILED SID J. WHITE JAN 28 1987 CLERK, SUPREME COURT"

BY: (no signature) Deputy Clerk

Notice Of Appeal to the United States Supreme Court

NOTICE IS GIVEN that Shell Oil Company, Appellant, appeals to the United States Supreme Court, pursuant to 28 U.S.C. § 1257(a), the judgment of this Court in Shell Oil Company v. Department of Revenue, 496 So.2d 789, from which rehearing was denied on November 24, 1986.

Respectfully submitted,

Lloyd Kennedy, Esq.
Shell Oil Company
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001
(713) 241-3386

Arthur J. England, Jr., Esq.
Charles M. Auslander, Esq.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

CERTIFICATE OF SERVICE

I certify that true and correct copies of this Notice were mailed on January 27, 1987 to Sharon A. Zahner, Esq. and to Joseph C. Mellichamp, III., Esq., Assistant Attorneys General, Department of Legal Affairs, Tax Section, Capitol Building, Tallahassee, Florida 32399-1050.

/s/ Arthur J. England, Jr.

Appendix 6

Article VI, clause 2 of the United States Constitution provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Appendix 7

43 U.S.C. § 1331(a) (1972) provides:

(a) The term "outer Continental Shelf" means all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control.

Appendix 8

43 U.S.C. § 1301 (1972) provides:

(a) The term "lands beneath navigable waters" means --

(1) all lands within the boundaries of each of of the respective States which are covered by nontidal waters that were navigable under the laws of the United States at the time such State became a member of the Union, or acquired sovereignty over such lands and waters thereafter, up to the ordinary high water mark as heretofore or hereafter modified by accretion, erosion, and reliction;

(2) all lands permanently or periodically covered by tidal waters up to but not above the line of mean high tide and seaward to a line

three geographical miles distant from the coast line of each such State and to the boundary line of each such State where in any case such boundary as it existed at the time such State became a member of the Union, or as heretofore approved by Congress, extends seaward (or into the Gulf of Mexico) beyond three geographical miles,[1] and

(3) all filled in, made, or reclaimed lands which formerly were lands beneath navigable waters, as hereinabove defined;

(b) The term "boundaries" includes the seaward boundaries of a State or its boundaries in the Gulf of Mexico or any of the Great Lakes as they existed at the time such

---

1. So in original. Probably should be a semicolon.

State became a member of the Union, or as heretofore approved by the Congress, or as extended or confirmed pursuant to section 1312 of this title but in no event shall the term "boundaries" or the term "lands beneath navigable waters" be interpreted as extending from the coast line more than three geographical miles into the Atlantic Ocean or the Pacific Ocean, or more than three marine leagues into the Gulf of Mexico;

(c) The term "coast line" means the line of ordinary low water along that portion of the coast which is in direct contact with the open sea and the line marking the seaward limit of inland waters;

(d) The terms "grantees" and "lessees" include (without limiting the generality thereof) all politi-

cal subdivisions, municipalities, public and private corporations, and other persons holding grants or leases from a State, or from its predecessor sovereign if legally validated, to lands beneath navigable waters if such grants or leases were issued in accordance with the constitution, statutes, and decisions of the courts of the State in which such lands are situated, or of its predecessor sovereign: Provided, however, That nothing herein shall be construed as conferring upon said grantees or lessees any greater rights or interests other than are described herein and in their respective grants from the State, or its predecessor sovereign;

(e) The term "natural resources" includes, without limiting the generality thereof, oil,

gas, and all other minerals, and fish, shrimp, oysters, clams, crabs, lobsters, sponges, kelp, and other marine animal and plant life but does not include water power, or the use of water for the production of power;

(f) The term "lands beneath navigable waters" does not include the beds of streams in lands now or heretofore constituting a part of the public lands of the United States if such streams were not meandered in the connection with the public survey of such lands under the laws of the United States and if the title to the beds of such streams was lawfully patented or conveyed by the United States or any State to any person;

(g) the term "State" means any State of the Union;

(h) The term "person" includes, in addition to a natural person, an association, a State, a political subdivision of a State, or a private, public, or municipal corporation.

Appendix 9

43 U.S.C. § 1333(a) (1972) provides:

(a) Constitution and United States laws; laws of adjacent States; publication of projected State lines; International boundary disputes; restriction on State taxation and jurisdiction

(1) The Constitution and laws and civil and political jurisdiction of the United States are hereby extended to the subsoil and seabed of the outer Continental Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of tran-

sporting such resources, to the same extent as if the outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State: Provided, however, That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this subchapter.

(2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries

were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf.

(B) Within one year after September 18, 1978, the President shall establish procedures of setting[1] any outstanding international boundary dispute respecting the outer Continental Shelf.

---

1. So in original. Probably should be "settling".

(3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.*

---

* In 1978, Pub. L. 95-372 redesignated former subsection (a)(2) as subsection (a)(2)(A) but did not revise the language of that section.

Appendix 10

Section 220.02(4)(a), Florida Statutes (Supp. 1972) provides:

(4) It is the intent of the legislature that the tax imposed by this code shall be prospective in effect only. Consistent with this intention and the intent expressed in subsection (3), it is hereby declared to be the intent of the legislature that:

(a) "Income," for purposes of this code, including gains from the sale, exchange, or other disposition of property, shall be deemed to be created for Florida income tax purposes at such time as said income is realized for federal income tax purposes;

Appendix 11

Section 220.02(5), Florida Statutes (Supp. 1972) provides:

(5) It is the intent of the legislature that if there is included in any taxpayer's net income subject to tax under this code any item or items of income which are determined to be improperly so included because of a conflict with any federal statute, the Constitution of the United States, or the state constitution, all such items of income shall be excluded from the net incomes of all taxpayers subject to tax under this code, but all other provisions of this chapter, and their application, shall not be invalidated or in any way impaired by such required exclusion of an item or items of income.

Appendix 12

Section 220.15, Florida Statutes (Supp. 1972) provides:

220.15 Apportionment of adjusted federal income. -- Adjusted federal income as defined in §220.13 shall be apportioned to this state in accordance with part IV of chapter 214, and for the purpose of applying said part to this code:

(1) The term "sales" in paragraph 214.71(3)(a) shall mean all gross receipts of the taxpayer except interest, dividends, rents, royalties, and gross receipts from the sale, exchange, maturity, redemption, or other disposition of securities; except that:

(a) Rental income shall be included in the term "sales" whenever a significant portion of the taxpayer's business consists of leasing or renting tangible personal property;

(b) Royalty income shall be included in the term "sales" whenever a significant portion of the taxpayer's business consists of dealing in or with the production, exploration, or development of minerals; and

(2) The term "financial organization" in paragraph 214.71(3)(b) shall include any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, or investment company; and

*(3) The term "everywhere" in part IV of chapter 214, which is used in the computation of apportionment factor denominators, shall mean "in all states of the United States, the District of Columbia, or any political subdivision of the foregoing"; and

(4) In lieu of the equally weighted three factor apportionment fraction based on property, payroll, and sales which is described in §214.71, there shall be used for purposes of the tax imposed by this code an apportionment fraction composed of a sales factor representing 50 percent of the fraction, a property factor representing 25 percent of this fraction, and a payroll factor representing 25 percent of the fraction. However, upon application in accordance with paragraph (a), any taxpayer shall be entitled to a refund of tax, in an amount determined under paragraph (b), if it can establish that the aggregate amount of its net income subject to tax under this code and in all other states for the taxable year exceeds 100 percent of the taxpayer's taxable income, as determined for federal income tax purposes, for the taxable year.

(a) Any taxpayer eligible for a refund under this subsection shall make application therfor in accordance with procedures set forth in part I of chapter 214. All applications for refund under this subsection shall be accompanied by a copy of the taxpayer's federal income tax return for the taxable year, copies of every return filed by the taxpayer in the states in which it has conducted business for the taxable year, and verification in the form of cancelled checks or other receipts of the taxpayer's payments of the amounts shown to be due on the several returns filed with the refund application.

(b) The refund to which any taxpayer shall be entitled under this subsection shall be equal to 5 percent of the lesser of:

1. The excess of the amount subject to tax for the taxable year under

this code over the amount which would have been subject to tax if the taxpayer had computed net income for purposes of this code on the basis of the apportionment fraction described in §214.71; or

2. The excess of the aggregate amount of net income subject to tax in Florida and in all other states for the taxable year over the amount of federal taxable income for the taxable year.

(c) For purposes of this subsection, the terms "net income subject to tax" and "amount subject to tax" shall mean the amount against which a rate or rates are applied in determining the taxpayer's dollar liability for tax in any jurisdiction.

Appendix 13

Section 214.71, Florida Statutes (1971) provides:

214.71 Apportionment; general method. --- Except as otherwise provided in §§214.72 and 214.73, the base upon which any tax made applicable to this chapter shall be apportioned shall be determined by multiplying same by a fraction the numerator of which is the sum of the property factor, the payroll factor, and the sales factor and the denominator of which is three. In the event any of the factors described in subsections (1), (2), or (3) has a denominator which is zero or is determined by the department to be insignificant, the denominator of the apportionment fraction shall be reduced by the number of such factors.

(1) The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year or period and the denominator of which is the average value of such property owned or rented and used everywhere.

(a) Real and tangible personal property owned by the taxpayer shall be valued at original cost. Real and tangible personal property rented by the taxpayer shall be valued at eight times the net annual rental rate paid by the taxpayer less any annual rental rate received from subrentals.

(b) The average value of real and tangible personal property shall be determined by averaging the value at the

beginning and the end of the taxable year or period, unless the department determines that an averaging of monthly values during the taxable year or period is reasonably required to reflect properly the average value of the taxpayer's real and tangible personal property.

(2) The payroll factor is a fraction the numerator of which is the total amount paid in this state during the taxable year or period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the taxable year or period.

(a) The term "compensation" shall mean wages, salaries, commissions, and any other form of remuneration paid to employees for personal services.

(b) Compensation is paid in this state if:

1. The employee's service is performed entirely within the state; or

2. The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state; or

3. Some of the employee's service is performed in the state and

a. The base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or

b. The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed and the employee's residence is in this state.

(3) The sales factor is a fraction the numerator of which is the total sales of the taxpayer in this state during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period.

(a) Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser within this state, regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state, and either the purchaser is the United States government or the taxpayer is not subject to a comparable tax on the sale in the state of the purchaser.

(b) Sales of a financial organization, including, but not limited to,

banking and savings institutions, investment companies, real estate investment trusts, and brokerage companies, shall be in this state if derived from:

1. Fees, commissions, or other compensation for financial services rendered within this state;

2. Gross profits from trading in stocks, bonds, or other securities managed within this state;

3. Interest and dividends received within this state;

4. Interest charged to customers at places of business maintained within this state for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts; and

5. Any other gross income resulting from the operation as a financial organization with this state.

(c) In computing the amounts referred to in this subsection, any amount received by a member of an affiliated group (determined under §1504(a) of the Internal Revenue Code, but without reference to whether any such corporation is an "includable corporation" under §1504(b) of the Internal Revenue Code) from another member of such group shall be included only to the extent such amount exceeds expenses of the recipient directly related thereto.

Supreme Court, U.S.
FILED
MAY 8 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1593

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1986

SHELL OIL COMPANY,

Appellant

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA

Appellee

On Appeal from the
Supreme Court of Florida

Motion of Appellee, Department of Revenue to Dismiss or Affirm

---

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32399-0100
(904)488-0712

COUNSEL OF RECORD FOR APPELLEE

Robert A. Butterworth
Attorney General
Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahasssee, Florida 32399-1050
(904)487-2142

OF COUNSEL

TABLE OF CONTENTS

	Page
Question Presented.....	i
Parties to Precedings Below.....	i
Table of Contents.....	ii
Table of Authorities.....	iv
Motion to Dismiss or Affirm.....	1
Statutory Provisions Involved.....	1
Statement of the Case.....	2
Reasons for Dismissal or Affirmation.....	17
Conclusion.....	28

Appendices:

1. Section 220.13, Florida Statutes (1973).....	1-1

(2-10)
Shell Oil Company v. Department Revenue, No. 80-987 (Fla. 2d. Jud. Cir.. March 24, 1983).

2. Amended Complaint.....	2-1
3. Answer and Defenses to Amended Complaint.....	3-1
4. Affidavit of Larry Churchill.	4-1

5. Exhibit H to Affidavit of.... 5-1
J.L. Kennedy, Final Notice of
Administrative Decision,
Letter dated February 4,
1980 from George T. Yore

6. Motion to Amend..... 6-1

7. Defendant's Initial..... 7-1
Interrogatories to Plaintiff;
November 29 with Answer

8. Shell Oil Company's Motion... 8-1
for Summary Judgment

9. Amendment to Motion for..... 9-1
Summary Judgment

10. Department of Revenue's..... 10-1
Motion for Summary Judgment

(11-16)
Shell Oil Company v. Department
of Revenue, 496 So.2d 789
(Fla. 1986).

11. Petitioner's Initial..... 11-1
Brief, Page 5

12. Motion for Rehearing.....12-1

13. Response to Motion for..... 13-1
Hearing

14. Motion for Order Com-..... 14-1
pelling Compliance with
Court Decision

15. Motion to Strike and..... 15-1
Expunge Record

16. Response to Motion to..... 16-1
Strike and Expunge

TABLE OF AUTHORITIES

Page

CASES:

Exxon Corporation v. Wisconsin Department of Revenue, 447 U.S.207 (1980). 20

Helvering v. Horst, 311 U.S. 112 (1940). ..22

Maryland v. Louisiana, 451 U.S. 725 (1981). 27

Mobil Oil Corporation v. Commissioners of Taxes of Vermont, 445 U.S. 425 (1980). 19

New Colonial Ice Company v. Helvering, 292 U.S. 435 (1934). 19

Shell Oil Company v. Department of Revenue, 496 So.2d 789, (Fla. 1986). ...14, 16, 23, 27

Shell Oil Company v. Department of Revenue, 461 So.2d 959 (Fla. App. 1 Dist. 1984). ...12

United States v. Balanowski, 236 F.2d 298 (2d Cir. 1956). 24

Welch v. Helvering, 290 U.S. 111 (1933) ..19

STATUTES:

I.R.C. §63(a) 25

I.R.C. §613.....25, 26

I.R.C. §613A.....25, 26

I.R.C. §7701(a)(9).....16

43 U.S.C. §1333(a)(2)(A) (1970)...i, 2, 28

Section 220.13, Florida Statutes..1 (1973)

RULES:

Sup. Ct. R. 16.....1

Tax Court Rule 142.....19

OTHER:

Delaney, Adler, Espstein and.....21 Foran, GAAP-Interpretation and Application, (1985 ed.).

Solomon, Gross Income-Conceptual..22 Aspects, (1986).

MOTION TO DISMISS OR AFFIRM

Pursuant to Sup. Ct. R. 16, the Appellee, Department of Revenue of the State of Florida (Department), moves to dismiss this appeal on the grounds that it does not present a substantial federal question, the federal question as presented by Appellant (Shell) in its jurisdictional statement was not properly raised nor expressly passed on, and the judgment rests on an adequate non-federal basis or to affirm the decision of the Supreme Court of Florida.

STATUTORY PROVISIONS INVOLVED

This appeal raises the question of whether the inclusion of the income derived from the sale of oil within the various states of the United States in the apportionable tax base pursuant to §220.13, Florida Statutes, (Appendix 1), is repugnant to the limitation on a state's jurisdiction to levy taxes con-

tained in 43 USC §1333(a)(2)(A) (1970).

STATEMENT OF THE CASE

Shell's statement of the case contains utterances of purported fact which are not contained in or which cannot be adduced from the record of the case below. Hence, the Department presents its statement which is founded squarely on pertinent parts of the record below.

Shell is engaged in the oil and gas business and explores for and produces gas and refines and manufactures oil and gas into products which, in turn, are marketed by Shell. Shell markets its products, including chemicals, generally throughout the United States, its primary business in Florida being marketing. (Appendix 2).

Shell alleged that its Florida income taxes for the tax years 1972, 1973, 1974 and 1975 and Shell's oil and gas production business are involved in this

controversy. (Appendix 2). The Department admitted this allegation subject to the reservation that Shell's "production business" is inseparable from its "marketing business." (Appendix 3).

Shell alleged that its net income for the tax years in controversy was earned from its "production business" on the outer continental shelf (OCS). (Appendix 2). The Department admitted that Shell engaged in such production activities; however it denied that Shell's earnings of net income were derived from these activities alone, but arose from production activities coupled with marketing activities in the 50 states and the District of Columbia. (Appendix 3).

Shell alleged that the Department had included "OCS income" in the apportionable tax base but excluded OCS property and payroll from the denominators of two of the three fractions of the

apportionment formula and that the Department did not exclude "OCS sales" from the sales factor denominators. (Appendix 2). The Department admitted this allegation, but denied that Shell had signficant OCS sales. (Appendix 3). Thus, the factual issue of whether Shell had consummated by delivery any sales upon the OCS (other than possible de minimis amounts) was fairly joined in the pre-trial pleadings.[1]

The affidavit of the Department's auditor addressed how the Department corrected Shell's returns stating:

> In each of its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil exluded from its income, determined for federal income tax purposes, its wellhead fair market value of OCS oil, less related costs and expenses. Shell also excluded OCS property, OCS payroll and a wellhead fair market value of

[1] The Department notes that documentary evidence of Shell's having consummated (by delivery) any sales on the OCS, if any, was and remains exclusively within Shell's control.

> OCS oil from the denominators of the property, payroll and sales factors of the apportionment formula contained in §214.71, F.S., as modified by §220.15, F.S.
>
> ****
>
> During the audit of Shell Oil, I restored the fair market value, at the wellhead, of OCS oil to the sales factor for the apportionment formula. (Appendix 4).

The Department's final notice of its administrative decision asserted the reason such correction of Shell's returns was proper.

> At first blush it would appear that since the Department of Revenue is attempting to tax the income from Shell Oil Company's O.C.S. oil production that in deference to basic equity it should permit the inclusion of O.C.S. property and payroll values in the factoring denominators of the years being contested.
>
> Such a simplistic proposition would have to receive some sort of recognition if it squared with the facts which it does not since Florida is not taxing O.C.S. income but is taxing the ultimate sales of such production after it is piped, barged or boated to domestic refinery facilities.
>
> In short, such sales, based on the facts presently before us, are non-severable from total sales domestically...(Appendix 5).

Shell further alleged:

> The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:
> (a) OCS income was included by the Department in income subject to tax by Florida;
> (b) Alternatively, OCS income was included by the Department in income subject to tax by Florida without allowance of an offset to the extent that an offset would be produced by including OCS property and payroll in the respective pertinent fractions of the Apportionment Formulas;
> (c) Omitted.
> (d) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in several respects including that Florida did not have nexus with the Plaintiff's OCS income supporting the taxation of that income...(Appendix 2).

The Department's response was as follows:

> Defendant responds to the allegations of Paragraph 13 as follows:
> (a) The allegations of Paragraph 13(a) are admitted, but the allegations that such action is incorrect or illegal is denied.
> (b) The allegations of Paragraph

13(b) are admitted, but the allegation that such action is incorrect or illegal is denied.
(c) Omitted.
(d) The allegations of Paragraph 13(d) are denied. (Appendix 3).

Shell, in its Amended Complaint, prayed for relief as to both computation of the income base and modification of the apportionment formula. However, prior to entry of the trial court's final judgment, Shell withdrew its second prayer for relief which sought modification of the apportionment formula and had required establishment of the controverted fact of OCS sales. (Appendix 6).

As part of its pre-trial preparation, the Department submitted an initial set of interrogatories to Shell. Interrogatory No. 29 and Shell's answers thereto are as follows:

29. (a) Does Plaintiff sell any of the products from its OCS production operations to purchasers not affiliated with Plaintiff in sales which take place outside the 50 states and District of Columbia?

Yes, the Plaintiff sells some of its oil and gas production to indpendent purchasers on the OCS, which is outside the 50 states and District of Columbia.

(b) Where are these sales made (i.e., at the wellhead, in foreign ports)?

They are made at or near the offshore wellhead.

(c) What percentage of Plaintiff's total OCS production (in barrels, cubic feet, etc.) was sold in the sales described in interrogatory 29 (a) for each year in controversy?

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

(Appendix 7).

Before the Department could seek documentary evidence to validate Shell's contentions of "OCS sales," Shell altered litigation strategy by filing its motion for Summary Judgment, which, stated:

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") violates the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. If Shell's income derived from its production business on the OCS

> should be included in Shell's net income for Florida income tax purposes, such income should be apportioned to Florida by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula"), or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in denominators of the Apportionment Formula. (Appendix 8).

Critically, Shell petitioned for inclusion of OCS sales as well as OCS property and payroll in the apportionment formula in paragraph 2.

Subsequently, Shell amended its motion for summary judgment and withdrew paragraph 2 thereof. (Appendix 9). Thus, Shell not only waived OCS property and payroll, but also Shell waived OCS sales.

The Department also filed a motion for summary judgment stating therein:

> 1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") does not violate the Outer Continental Shelf Lands Act, 43 U.S.C. s. 1333(a)(2). (Appendix 10).

The final judgment entered by the trial court contains a concise statement of the case as presented to that court; to wit:

> Both Shell and the Department of Revenue of the State of Florida (the "Department") moved for summary judgment, and the court has previously entered two orders, both dated February 3, 1983, ruling on these motions. After deciding the motions for summary judgment, only one issue remained for determination, i.e., whether Shell's income derived from its production business on the Outer Continental Shelf ("OCS") should be apportioned by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula") or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in the denominators of the Apportionment Formula. Although this issue was originally part of Shell's motion for summary judgment, Shell withdrew this issue prior to the summary judgment hearing. The court has denied the Department's motion for summary judgment on this issue. Shell has now filed a motion to amend to delete its prayer for relief relating to this withdrawn issue, and upon ruling on the motion to amend all issues will have been decided on summary judgment. Therefore, it is ORDERED AND ADJUDGED as follows:

1. Shell's Motion to Amend to delete its prayer for relief relating to the withdrawn issue is hereby granted.
2. The court adopts its orders dated February 3, 1983, on the motions for summary judgment filed by Shell and the Department as follows:

(a) Shell's Motion for Summary Judgment on the first issue raised by Shell, i.e., whether the treatment by the Department of Shell's income derived from its production business on the OCS violated the Outer Continental Lands Act, 43 U.S.C. s. 1333(a)(2) is denied, and the Department's Motion for Summary Judgment on this issue is granted. (Shell Appendix 3).

Thus, Shell overtly and constructively withdrew both its controverted claim of having consummated by delivery any sales whatsoever upon the OCS and withdrew its allegation that the apportionment method applied by Florida was constitutionally flawed. Shell did not pursue alternatives available at the trial court level but chose to pursue its appeal on the sole issue recognized and resolved by the trial court.

In its decision, the First District

Court of Appeals of Florida stated:

> ...the income in Shell's case was realized totally from sales of oil in the various states of the United States.

Shell Oil Co. v. Dept. of Revenue, 461 So.2d 959, 961 (Fla. App. 1 Dist. 1984). Shell did not thereafter request a rehearing in the District Court of Appeals for the First District of Florida to clarify any facts which the court may have overlooked or misapprehended.

In its initial brief to the Florida Supreme Court, Shell reaffirmed its withdrawal at the trial court of any potential for constitutional challenge to the method of apportionment.

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (Appendix 11).

Shell thereby also constructively reaffirmed its waiver of any contention of having consummated sales on the OCS.

The following excerpts from the decision of the Supreme Court of Florida are expositive of the statement of the case:

> The Florida Department of Revenue (DOR) disallowed Shell's exclusion of certain OCS production income from its Florida tax base for fiscal years 1972-75.
>
> ****
>
> Further, DOR concedes that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by section 1333(a)(2). Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.
>
> DOR contends that because Shell sold the oil within the boundaries of the fifty states, and not on the OCS, the taxable event occurred within the reach of Florida's tax law. On the other hand, Shell contends that the time and location of the actual sale are irrelevant because no sale of OCS production can ever be subject to state taxation. Shell claims that section 1333(a)(3) of the Outer Continental Shelf Lands Act supports this contention.
>
> ****
>
> We find that Shell's reliance on section 1333(a)(3) is misplaced. Although section 1333(a)(3) prevents states from claiming an interest in or jurisdiction over the revenues

> derived from OCS natural resources, the language of this subsection when read in conjunction with the rest of section 1333(a) simply constitutes a limitation of state authority over the OCS area and does not seem intended to address income derived outside the OCS.
>
> ****
>
> ...In the instant case Shell realized the income within the fifty states and both parties agree that Florida can generally levy an apportioned tax on income derived within any of the fifty states. Thus Shell has offered no relevant authority for its claim that OCS production sold in the states should be an exception to the norm. As the district court pointed out, taking Shell's argument to its logical conclusion, no state could impose any kind of tax on any final product which eventually might be derived from OCS production. We join the district court in finding that Congress never intended such a sweeping result when it passed the Outer Continental Shelf Lands Act....

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 790, 791 (Fla. 1986).

In its motion for rehearing to the Supreme Court of Florida, Shell sought to resurrect its twice waived challenge to the apportionment formula. (Appendix 12). The Department's response specifically asserted Shell's lack of standing.

(Appendix 13).

Shell also filed a motion for order compelling compliance with court decision, attaching several documents thereto. (Appendix 14). By this motion, Shell attempted to resurrect the controverted question of the existence of actual sales consummated upon the OCS which it had abandoned in pursuing its litigation strategy attendant to and flowing from the summary judgment proceedings. The Department moved to strike. (Appendix 15). Shell responded. (Appendix 16).

Shell's motion for rehearing was denied and the Department's motion to strike was granted. (Shell Appendix 4).

In its jurisdictional statement, Shell paraphrases statements made by the Supreme Court of Florida.

> ...In the case of natural gas, all transfers were made by sale to non-affiliated, independent pipeline

> companies which rent space and take delivery of the gas on the platform....(page 7).

The trial court record does not establish that Shell delivered natural gas to pipelines of third parties on the OCS. Doubtless, references to such sales are gratuitous utterances in response to Shell's argument of its waived inchoate factual issue. These references are clearly excluded from the certified question the Supreme Court of Florida stated it was addressing.

> Whether the State of Florida is prohibited by U.S.C. s. 1333(a)(2)(A) [sic] from imposing a tax upon income derived from the sale in the United States of oil extracted from the outer Continental Shelf?[2]

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 789 (Fla. 1986).

---

[2] Section 7701(a)(9) of the Internal Revenue Code of 1986 provides: United States--the term "United States" when used in a geographic sense includes only the States and the District of Columbia.

Shell's jurisdictional statement enlarged the question presented beyond that addressed by the Florida courts to include hypothetical elements.

The Department has also modified the question. However, the Department's version assures clarity and rests wholly within the parameters of the record below.

REASONS FOR DISMISSAL OR AFFIRMATION

The Department asserts that the Supreme Court of Florida utilized the appropriate burden of proof to determine that the income Shell derived from oil sold in the various states was includable in Florida's tax base. The decision conforms with concepts of income under generally accepted accounting principles (GAAP) and federal concepts of realization. The decision relies on and conforms to this Court's decisions regarding the ability of the states to tax income given

specific geographic situs. And finally, the decision is not repugnant to any federal statute nor the U.S. Constitution. Thus, there is no prohibition against Florida's inclusion of the income in its apportionable tax base, and hence, this case presents no substantial federal question.

Shell below has waived the apportionment argument, and consequently any fact of sales on the OCS; therefore, the only remaining question is whether income derived from sales in the various states is includable in Florida's apportionable tax base.

As to Shell's lack of standing with regard to a possible constitutional issue steming from apportionment, the Department restates the extract from Shell's Initial Brief to the Supreme Court of Florida in which it reaffirmed its waiver below.

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (e.s.) (Appendix 11).

Any question as to the possible latent constitutional infirmity of the state's chosen apportionment method is waived where the taxpayer voluntarily elects to limit its attack by addressing solely the tax base. Mobil Oil Corp. v. Commissioners of Taxes of Vermont, 445 U.S. 425 (1980).

When claiming an erosion of the initial tax base, the burden rests with the taxpayer to point to an applicable statute and demonstrate he comes within its terms. New Colonial Ice Co. v Helvering, 292 U.S. 435 (1934); and Tax Court Rule 142. The burden of proof is intertwined with the presumption that the tax administrator's determination of a deficiency in tax is prima facie correct. Welch v. Helvering, 290 U.S.

111 (1933).

Mere internal transfers of crude oil between Shell's production division and Shell's marketing division are non-events for income tax accounting purposes, regardless of assignment of artificial "prices" to such transfers for internal purposes. Shell is a vertically integrated petroleum company and as such its production, refining and marketing divisions are unitary. The respective contributions of the production division, refining division, and the marketing division which generate the entire net income are inexorably intertwined and it is constitutionally permissible to require aggregation of the income of all divisions in a single apportionable tax base. Exxon Corporation v. Wisconsin Department of Revenue, 447 US 207 (1980).

Under generally accepted accounting principles, income is normally not con-

sidered as existing before it is fully realized.

> Realization. The process of converting noncash resources and rights into money or, more precisely, the sale of an asset for cash or claims to cash....
>
> ...the earnings process occurs throughout the various stages of production, sales and final delivery of the product. However, the difficulty in measuring the precise rate at which this earnings process is taking place has lead accountants to conclude that income should normally be recognized only when it is fully realized. Realization generally implies that the enterprise producing the item has completed all of its obligations relating to the product and that collection of the resulting receivable is assured beyond reasonable doubt.

Delaney, Adler, Epstein, and Foran, GAAP-Interpretation and Application, pp. 44, 45 (1985 ed.)

The identical realization concept is contained in federal income tax law.

> Section 61(a) incorporates a realization requirement in the definition of gross income. The section refers to "income from whatever source derived," "Gross income derived from

business," and "Gains derived from dealings in property."
To be taxed, gains must be realized, that is, sufficiently fixed and definite to be treated as gross income. Realization generally connotes a sale of an asset for cash or its exchange for other property. As a result of the realization requirement, the income tax taxes transactions.

****

In Helvering v. Horst,[3] decided shortly after Helvering v. Brunn, the Supreme Court amplified its definition of the realization requirement as the taxable event that occurs "when the last step is taken by which [the taxpayer] obtains the fruition of economic gain which has already accrued to him." The Court also explicity characterized the realization requirement as one "founded on administrative convenience."

Solomon, Gross Income-Conceptual Aspects, p. A-30, 31 (1986).

Thus, no income is realized prior to the consummation of an actual sale. Shell's concept that the act of extraction of oil creates "production income" does not exist either under GAAP or under

3 311 U.S. 112 (1940)

the IRC.

The Supreme Court of Florida stated as follows:

> In the case at bar, this realization occurred at the time of sale. Clearly, no realization of income occurred at the wellhead, despite Shell's assignment of an artifical wellhead price to the oil, because Shell received no actual economic gain from any "sale, exchange, or other disposition of property" at that point. §220.02(4)(a). Rather, realization occurred at the time Shell sold the oil in the states because only at that time did Shell derive any actual economic gain.

Shell Oil Co. v. Dept. of Revenue, 496, So.2d 789, 791 (Fla. 1986).

"Production income" is "phantom income" under these concepts. Shell construes the OCS Lands Act to authorize such "phantom income" by inference. Had Congress intended such a radical departure from established income tax and accounting concepts, it would have so provided clearly and unequivocally.

Under federal income tax concepts,

jurisdication is based on "residence" of domestic entities and is exercised world-wide with a credit allowed for foreign taxes. However, the case of a foreign entity provides insight as to assigning geographic situs to income for tax purposes. A foreign entity is subject to federal jurisdiction based upon situs of the business activity of consummating a sale.

> (4) Under 199(a)(6) and (e) of the 1939 Code, a nonresident alien engaged in business here derives income from the sale of personal property in the country in which [the goods are] sold.

United States v. Balanowski, 236 F.2d 298, 304 (2d Cir 1956). Where production occurs without a state's geographic limits and no sale has occurred, the costs of production are merely assigned as the value of property held in inventory. This is true of motor vehicles produced in Japan and Germany, of

diamonds extracted in Africa and of oil extracted in the Middle East or within a given state.

In its jurisdictional statement, Shell states that a "sales equivalent" is used "...for computing income from Shelf property under sections 613 and 613A of the IRC where there have been no sales to independent third parties...." To preclude possible misapprehension, the Department notes that for both federal and Florida income tax purposes, Shell, as a general corporation, computes "taxable income" pursuant to section 63(a) of the IRC.

The value of extracted petroleum products measured at the wellhead based upon artificial "prices" is used as a lesser included mathematical convention specifically for the limited purpose of determining the allowable deduction in respect of depletion as authorized pursu-

ant to section 613 and 613A of the IRC, and is not used to determine gross income.

Next, Shell's jurisdictional statement references the fact that Senator Long of Louisana, arguing in support of a subsequently rejected proposed amendment to the Outer Continental Shelf Lands Act objected to the intended result that "....the employers...are subject neither to the State's severance tax, property tax nor the tax on corporate profits." To place this quotation in context, the rejected amendment was intended to prescribe state jurisdiction coterminus with that of the federal government. The activities, events and transactions contemplated by Senator Long were those expected to occur on the OCS, and not to transactions or events which subsequently occur clearly within the recognized geographic limits (3-mile) of a given state.

Finally, Shell relies heavily upon the Court's decision in Maryland v. Louisiana, 451 U.S. 725 (1981) to demonstrate that Florida is laying its income tax upon activities which occur on the OCS. Shell's view of the rationale of that decision rests on analogy to a severance tax and not to an income tax. The respective thresholds for imposition of each differ critically. Further, the Supreme Court of Florida stated at footnote 2:

> If this were not so, we would be at a loss to understand why the United States Supreme Court, in Maryland v. Louisiana, 451 U.S. 725, 101 S.Ct. 2114, 68 L.Ed.2d 576 (1981), tested the validity of Louisiana's "first use" tax by examining its effect on inter-state commerce rather than by scrutinizing the viability of taxing gas derived from the outer continental shelf.

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 790 (Fla. 1986).

In the case sub judice, Florida is laying its income tax upon its apportioned share

of income derived by Shell from sales consummated within the various states of the United States.

CONCLUSION

The sole question before this Court as presented by the Department herein was properly resolved by the Supreme Court of Florida. Florida's jurisdiction to tax as validated by that court is not repugnant to 43 USC §1333(a)(2)(A) (1970) nor any constitutional provision and is wholly in harmony with standing decisions of this Court. Shell's self-deluding illusion of "production income" is and remains non-existent "phantom income." The income realized from actual sales of oil consummated within the various states of the United States is properly includable in Florida's apportionable tax base. Therefore, this case presents no substantial federal question. Accordingly, the Department respectfully urges

this Court to grant its motion to dismiss Shell's appeal or to affirm the decision of the Supreme Court of Florida.

Respectfully submitted,

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32301
(904)488-0712

COUNSEL OF RECORD
FOR APPELLEE

ROBERT A. BUTTERWORTH
ATTORNEY GENERAL

Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahassee, Florida 32399-0150
(904)487-2142

OF COUNSEL

A P P E N D I X

Appendix 1

220.13 **Adjusted federal income defined.-**

(1) "Adjusted federal income" shall mean an amount equal to the taxpayer's taxable income as defined in subsection (2), or said taxable income of more than one taxpayer as provided in §220.131, for the taxable year, adjusted as follows:

(a) OMITTED

(b) Subtractions.-

1. In computing the net operating loss deduction allowable for federal income tax purposes under section 172 of the Internal Revenue Code for the taxable year, the net capital loss allowable for federal income tax purposes under section 1212 of the Internal Revenue Code for the taxable year, the excess charitable contribution deduction allowable for federal income tax purposes under section 170 (d)(2) of the Internal Revenue Code for

the taxable year, and the excess contributions deductions allowable for federal income tax purposes under section 404 of the Internal Revenue Code for the taxable year, there shall be subtracted from taxable income, in order to arrive at adjusted federal income, such amounts as reflect the following limitations:

a. No deduction shall be allowed for net operating losses, net capital losses, and excess contribution deductions under sections 170(d)(2) and 404 of the Internal Revenue Code which are carried forward from taxable years ending prior to January 1, 1972; and

b. The net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for any taxable year beginning before and ending after January 1, 1972 shall be limited to an amount

which bears the same ratic to the taxpayer's net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, for the entire taxable year as the number of days in such year after December 31, 1971 bears to the total number of days in such year, unless the taxpayer elects to account separately for income under subsection 220.12(3) of this code, in which case the net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for such year shall be determined on the basis of the items actually earned, received, paid, incurred, or accrued after December 31, 1971; and

c. A net operating loss and a capital loss shall never be carried back

as a deduction to a prior taxable year, but all deductions attributable to such losses shall be deemed net operating loss carryovers and capital loss carryovers, respectively, and treated in the same manner, to the same extent, and for the same time periods as are prescribed for such carryovers in section 172 and section 1212, respectively, of the Internal Revenue Code.

2. There shall be subtracted from such taxable income any amount included therein:

a. Under section 78 or section 951 of the Internal Revenue Code;

b. Which was derived from sales outside the United States, and from sources outside the United States as interest, as a royalty, or as compensation for technical or other services; and

c. Which was received as a dividend

from a corporation which neither transacts any substantial portion of its business in the United States nor regularly maintains any substantial portion of its assets within the United States.

However, as to any amount subtracted under this subparagraph, there shall be added to such taxable income all expenses deducted on the taxpayer's return for the taxable year which are attributable, directly or indirectly, to such subtracted amount.

(c) OMITTED

(2) For purposes of this section, a taxpayer's taxable income for the taxable year shall mean taxable income as defined in section 63 of the Internal Revenue Code and properly reportable for federal income tax purposes for the taxable year, but subject to the limitations set forth in paragraph (1)(b) with respect to the deductions provided by sections 172

(relating to net operating losses), 170(d)(2) (relating to excesscharitable contributions), 404(a)(1)(D) (relating to excess pension trust contributions), 404(a)(3)(A) and (B) (to the extent relating to excess stock bonus and profit-sharing trust contributions), 404(d) (relating to excess contributions under the 1939 code) and 1212 (relating to capital losses) of the Internal Revenue Code, except that, subject to the same limitations:

(a) "Taxable income," in the case of a life insurance company subject to the tax imposed by section 802 of the Internal Revenue Code, shall mean life insurance company taxable income; however, the amount of said income determined under paragraph 802(b)(3) of the Internal Revenue Code which shall be taken into account for purposes of this code shall never exceed, cumulatively,

the excess of amounts determined under said paragraph as of the close of the taxpayer's taxable year over the amount determined under said paragraph as of December 31, 1971;

(b) "Taxable income," in the case of a mutual insurance company subject to the tax imposed by section 821(a) or (c) of the Internal Revenue Code, shall mean mutual insurance company taxable income or taxable investment income, as the case may be;

(c) "Taxable income," in the case of an insurance company subject to the tax imposed by section 831(a) of the Internal Revenue Code, shall mean insurance company taxable income;

(d) "Taxable income," in the case of a regulated investment company subject to the tax imposed by section 852 of the Internal Revenue Code, shall mean investment company taxable income;

(e) "Taxable income," in the case of a real estate investment trust subject to the tax imposed by section 857 of the Internal Revenue Code, shall mean real estate investment trust taxable income;

(f) "Taxable income," in the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes, shall mean taxable income of such corporation for federal income tax purposes as if such corporation had filed a separate federal income tax return for the taxable year and each preceding taxable year for which it was a member of an affiliated group, unless a consolidated return for the taxapyer and others is required or elected under §220.131;

(g) "Taxable income," in the case of a cooperative corporation or association, shall mean the taxable income of such

organization determined in accordance with the provisions of section 1381 through 1398 of the Internal Revenue Code;

(h) "Taxable income," in the case of an organization which is exempt from the federal income tax by reason of section 501(a) of the Internal Revenue Code, shall mean its unrelated business taxable income as determined under Section 512 of the Internal Revenue Code; and

(i) "Taxable income," in the case of a corporation for which there is in effect for the taxable year an election under section 1372 of the Internal Revenue Code, shall mean the amount of income subject to tax at the corporate income tax level under paragraph 1372(b)(1) of the Internal Revenue Code for each taxable year.

Appendix 2

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. Case No. 80-987

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA,

Defendant. /

AMENDED COMPLAINT

Plaintiff Shell Oil Company sues defendant Department of Revenue of the State of Florida (the "Department") and alleges:

General Allegations

1. This is an action challenging a corporate income tax assessment by the Department, and this Court has jurisdiction under Article V, Section 20, Florida Constitution, and Sections 26.012, and 86.011 et. seq., Florida Statutes.

2. Plaintiff is a Delaware corporation with its principal place of business

in Houston, Texas, authorized to do business in Florida. Plaintiff is engaged generally in an oil and gas business and explores for and produces oil and gas and refines and manufactures oil and gas into products which in turn are marketed by Plaintiff.

3. Plaintiff produces oil and gas in more than a dozen states of the United States and on the Outer Continental Shelf of the United States ("OCS"). Plaintiff refines petroleum products in eight refineries in six states of the United States and in chemical plants in some of those six states and in other states.

4. Plaintiff markets its products, including chemicals, generally throughout the United States. Plaintiff's primary business in Florida is marketing.

5. It is the Plaintiff's Florida income taxes for 1972, 1973, 1974, and 1975 ("the Years in Controversy") and the Plaintiff's oil and gas production

business ("Production Business") that are involved in the controversy associated with this action.

As to the "OCS" Issue

6. Part of the Plaintiff's net income for the Years in Controversy was earned by the Plaintiff from its Production Business on the OCS.

7. In its Florida income tax returns for the Years in Controversy, the Plaintiff excluded income earned from its Production Business on the OCS from income apportionable to Florida, and, consistently therewith, excluded OCS real and tangible personal property from denominators of property fractions, OCS payroll from denominators of payroll fractions, and OCS sales from denominators of sales fractions of the apportionment formula contained in Section 214.71, Florida Statutes (the "Apportionment Formula").

8. After an audit of Plaintiff's returns for the Years in Controversy, the Department proposed to make additional assessments of Florida income taxes for the Years in Controversy by including OCS income in the tax base, and OCS property, payroll and sales in the denominators of respective fractions of the Apportionment Formula.

9. After a conference, instead of accepting the Plaintiff's position that OCS income, property, payroll and sales had to be excluded from the calculation of Florida taxable income, the Department enlarged the original audit as to this issue by including (as on the original audit) OCS income in apportionable income, but (different from the original audit) excluding OCS property and payroll from denominators of two of the three fractions of the Apportionment Formula. The Department did not exclude OCS sales from the sales

factor denominators.

10. The Department's enlargement of the initial audit was communicated to Plaintiff in a letter dated August 11, 1977.

11. The Plaintiff duly protested the Department's proposed assessments by a letter dated October 3, 1977, and asked the Department to reconsider its position.

12. The Department communicated its response (on this and other issues) by a letter dated February 4, 1980, which is taken by the Plaintiff to be the Department's final decision on the subject. The Plaintiff has elected judicial review by filing this action.

13. The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:

(a) OCS income was included by the

Department in income subject to tax by Florida;

(b) Alternatively, OCS income was included by the Department in income subject to tax by Florida without allowance of an offset to the extent that an offset would be produced by including OCS property and payroll in the respective pertinent fractions of the Apportionment Formula;

(c) The Department's apportionment method did not fairly represent the extent of the Plaintiff's tax base attributable to Florida, and the Plaintiff therefore petitions for relief under Section 214.73, Florida Statutes; and

(d) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the

Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in several respects including that Florida did not have nexus with the Plaintiff's OCS income supporting the taxation of that income, that the Department's apportionment was not internally consistent and did not constitute fair apportionment, that the Plaintiff would be discriminated against by the Department by this method of apportionment because other taxpayers are not taxed without full representation of property and payroll in the formula, and that Florida has not given benefit to the Plaintiff's OCS activities supporting the Department's tax on the Plaintiff's OCS income.

14. The Plaintiff believes and submits that Plaintiff and the Department can agree as to how tax may be correctly computed, once Florida and U.S. law are

construed in this case as to the principles to be followed.

As to the "IDC" Issue

15. In connection with its Production Business, the Plaintiff drills oil and gas wells from which a large portion of its income is derived.

16. In computing Federal and Florida taxable income, portions of the costs of drilling and equipping oil and gas wells must be capitalized, and portions are subject to being expensed. The parts subject to expense treatment are called "intangible drilling and development costs" ("IDCs") in the Internal Revenue Code and Regulations. IDCs are creatures of Federal tax law.

17. IDCs are items of such as the labor, fuel and hauling that go into the drilling of oil and gas wells. A producing oil and gas well has a cost, in ordinary usage, that includes the entire

cash outlay, without regard to its being partly capitalized and partly expensed for purposes of computing Federal taxable income.

18. The Plaintiff capitalizes (and depreciates) all of the costs of its producing oil and gas wells for financial (or "book") purposes in order to compute net income. The Plaintiff capitalizes (and depreciates) tangibles and expenses IDCs in order to compute taxable income for Federal income tax purposes, and in order to compute the tax base for Florida income tax purposes.

19. The Plaintiff filed its Florida income tax returns for the Years in Controversy by including all of the costs of its onshore producing oil and gas wells, including the IDCs, in the property fraction of the Apportionment Formula.

20. The Department audited and

excluded the Plaintiff's IDCs from the property fraction of the Apportionment Formula.

21. The Department thereby excluded a portion of the costs of the Plaintiff°s (all outstate) income producing assets from denominators of property fractions, and thereby augmented Florida°s apportionment of the Plaintiff°s taxable income for taxation by Florida.

22. The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:

(a) The Department°s treatment violated the provisions of Section 214.71(1)(a), Florida Statutes, which values owned real and tangible personal property at its "original cost" for Apportionment Formula purposes;

(b) Alternatively, the Department°s apportionment method did not fairly

represent the extent of the Plaintiff's tax base attributable to Florida, and the Plaintiff therefore petitions for relief under Section 214.73, Florida Statutes; and

(c) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in that, as applied, the apportionment was internally inconsistent and fair apportionment was not provided; and the Plaintiff was discriminated against in comparison with other taxpayers having their entire capital costs of includible properties represented in property fractions.

23. The Plaintiff believes and submits that Plaintiff and the Department can agree as to how tax may be correctly computed, once Florida and U.S. law are construed in this case as to the principles to be followed.

Mechanical Errors

24. The Department's audit schedules for 1974 reflect a Florida property factor of the Apportionment Formula of .003601, which is a mathematical error. Based on the Department's calculations contained in other parts of its audit schedules, the Florida property factor should be .003404.

25. The corrections of the mathematical error in the property factor results in an Apportionment Formula of .018686, rather than .018881 as calculated in the audit schedules.

26. The correction of the Apportionment Formula results in a

"Corrected Income Tax Liability" of $521.708 rather than $527,212 as shown on the Department's audit schedules.

Statute of Limitations

27. On about September 20, 1973, the Plaintiff filed its Florida income tax return for 1972, pursuant to a timely requested extension date of October 1, 1973.

28. Section 214.09, Florida Statutes, requires that the Department issue a notice of deficiency not later than three years after the date on which the return is filed, and unless such notice is issued within the required time, no deficiency may be assessed or collected with respect to that taxable year. The Plaintiff waived the expiration of this statute of limitations for the taxable year 1972 until December 31, 1976.

29. On December 14, 1976, the

Department sent to the Plaintiff a Notice of Proposed Deficiency for the Years in Controversy.

30. On August 11, 1977, after the period of limitations for the taxable year 1972 had run, the Department sent to the Plaintiff a revised Notice of Proposed Deficiency in which the December 14, 1976 proposed deficiency was enlarged for all the Years in Controversy (including 1972). Therefore, all or a portion of the proposed deficiency is barred by the applicable statute of limitations.

WHEREFORE, the Plaintiff prays that the Court will declare that:

I. The Department is required to compute the Plaintiff's income taxable by Florida by excluding the Plaintiff's taxable income attributable to the OCS, and, correspondingly, by excluding OCS property, payroll and sales from

denominators of the fractions of the Apportionment Formula.

II. Alternatively, as to I, the Department is required to compute the fractions of the Apportionment Formula by including OCS property, payroll and sales in denominators of the respective fractions.

III. The Department is required to compute the property fractions of the Apportionment Formula by including IDCs therein.

IV. The Department is required to correct mechanical or mathematical errors in its computation of Florida income taxes payable by Plaintiff.

V. The assessment by the Department of all or a portion of the Florida income taxes for the Plaintiff for 1972 is barred by the applicable statute of limitations.

VI. Such other and further relief as the Court may deem necessary.

Hume F. Coleman,
Stanley W. Rosenkranz and
Robert B. Glenn, Jr., of
HOLLAND & KNIGHT
Post Office 1288
Tampa, Florida 33601
(813)223-1621

Attorney's for Plaintiff

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to E. Wilson Crump, II, Assistant Attorney General and David K. Miller, Assistant Attorney General, Department of Legal Affairs, The Capitol, 1104, Tallahassee, Florida 32301, attorneys for Defendant, this 23rd day of July, 1980.

Stanley W. Rosenkranz

Appendix 3

IN THE CIRCUIT COURT OF THE
SECOND JUDICIAL CIRCUIT, IN
AND FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE
STATE OF FLORIDA

Defendant, /

ANSWER AND DEFENSES TO AMENDED COMPLAINT

Defendant, Department of Revenue of the State of Florida, answers the Complaint as follows:

1. The allegations of Paragraph 1 are admitted.

2. The allegations of Paragraph 2 are admitted.

3. The allegations of Paragraph 3 are admitted.

4. The allegations of the first sentence of Paragraph 4 are admitted. Defendant lacks knowledge of the allega-

tions of the second sentence of Paragraph 4 sufficient to admit or deny them, and therefore denies them.

5. The allegations of Paragraph 5 are admitted, subject to the reservation that Plaintiff's "production business" is inseparable from its "marketing business."

6. Defendant admits that Plaintiff engaged in production activities on the OCS during the years in controversy. Defendant denies that Plaintiff's earnings of net income were derived from these production activities alone, but from the production activities coupled with marketing activities in the 50 states and the District of Columbia. All subsequent responses to Plaintiff's allegations concerning income derived from OCS production activities are subject to this reservation.

7. The allegations of Paragraph 7

are admitted.

8. The allegations of Paragraph 8 are admitted.

9. The allegations of Paragraph 9 are admitted, but Defendant denies that Plaintiff had substantial OCS sales.

10. The allegations of Paragraph 10 are admitted. The Defendant communicated its revised audit position to Plaintiff prior to the date of the referenced letter, however.

11. The allegations of Paragraph 11 are admitted.

12. The allegations of Paragraph 12 are admitted.

13. Defendant responds to the allegations of Paragraph 13 as follows:

(a) The allegations of Paragraph 13(a) are admitted, but the allegation that such action is incorrect or illegal is denied.

(b) The allegations of Paragraph

13(b) are admitted, but the allegation that such action is incorrect or illegal is denied.

(c) The allegations of Paragraph 13(c) are denied.

(d) The allegations of Paragraph 13(d) are denied.

14. Defendant lacks knowledge of the allegations of Paragraph 14 sufficient to admit or deny them, and therefore denies them.

15. The allegations of Paragraph 15 are admitted.

16. The allegations of Pargraph 16 are admitted.

17. The allegations of the first sentence of Paragraph 17 are admitted. Defendant denies that the allegations of the second sentence of Paragraph 17 are applicable or material in this proceeding.

18. The allegations of Paragraph 18

are admitted.

19. The allegations of Paragraph 19 are admitted.

20. The allegations of Paragraph 20 are admitted.

21. The allegtions of Paragraph 21 are denied.

22. The allegations of Paragraph 22, and all subparagraphs, are denied.

23. Defendant lacks knowledge of the allegations of Paragraph 23 sufficient to admit or deny them, and therefore denies them.

24. Defendant admits that its audit schedules for 1974 reflect a Florida property factor in the apportionment formula of .003601. Defendant denies the remaining allegation of Paragraph 24.

25. The allegations of Paragraph 25 are denied.

26. The allegations of Paragraph 26 are denied.

27. The allegations of Paragraph 27 are admitted.

28. In response to Paragraph 28, Defendant would state that the cited statute speaks for itself. Defendant admits the second sentence of Paragraph 28.

29. The allegations of Paragraph 29 are admitted.

30. Defendant admits that it sent Plaintiff a revised Proposed Notice of Deficiency on August 11, 1977, in which the December 14, 1976 Notice of Deficiency was enlarged for the years in controversy. Defendant denies the remaining allegations of Paragraph 30.

All matters not specifically admitted are hereby denied.

FIRST DEFENSE

Defendant, for its First Defense, alleges that Plaintiff is estopped to assert relief based on the Defendant's

exclusion of intangible drilling and development costs from the property factor of the apportionment formula because of Plaintiff's election to treat these costs as expenses for federal and Florida income tax purposes.

SECOND DEFENSE

Defendant, for its Second Defense, alleges that Plaintiff waived, or is estopped from asserting, any claim based on the statute of limitations by virtue of its election to pursue informal administrative remedies within the Defendant.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

E. Wilson Crump, II
Ass't Attorney General

David K. Miller
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, Room LL04
Tallahassee, FL 32301
(904)487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the ANSWERS AND DEFENSES TO AMENDED COMPLAINT has been furnished by U.S. mail to Hume F. Coleman, P.O. Drawer 810, Tallahassee, Florida, 32302, Stanley W. Rosenkranz and Robert B. Glenn, Jr., P.O. Box 1288, Tampa, Florida 33601, this 4th day of August, 1980.

David K. Miller
Ass't Attorney General

Appendix 4

IN THE CIRCUIT COURT OF THE
SECOND JUDICIAL CIRCUIT, IN
AND FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff, CASE No. 80-987

vs.

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA,

Defendant. /

A F F I D A V I T

STATE OF FLORIDA

COUNTY OF LEON

BEFORE ME, the undersigned notary public authorized in the state and county named above to administer oaths and take acknowledgements, personally appeared Larry Churchill, who, being by me first duly sworn, deposes and says:

1. I was employed as a corporate income tax auditor with the Department of Revenue, State of Florida, from January, 1974 to December, 1978. From January 1,

1979 to June 30, 1979, I was the Acting Section Administrator for the Audit Classification Section. On July 1, 1979, I was appointed Section Administrator for the Audit Classification Section. Since August 2, 1982, I have been employed with the House Minority Office of the Florida Legislature. I have personal knowledge of the facts set forth herein.

2. The Department of Revenue, State of Florida, has the responsibility of regulating, controlling and administering all revenue laws and performing all other duties provided in Chapter 220, Florida Statutes ("income tax code").

3. In my capacity as a corporate income tax auditor, I was assigned the responsibility of auditing Shell Oil, a company generally engaged in the oil and gas business and authorized to do business in the State of Florida.

4. Shell Oil extracts oil from

wells on the Outer Continental Shelf (OCS). All refining and most marketing of OCS oil occurs within the continental United States. A portion of Shell Oil°s net income for the years 1972, 1973, 1974 and 1975 came from sales of OCS oil.

5. For the years 1972, 1973, 1974 and 1975, Shell Oil placed a value on its OCS oil for accounting and federal income taxation purposes. According to Shell Oil, this value is the fair market value, at the wellhead, of OCS oil, less related costs and expenses.

6. In each of its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil excluded from its income, determined for federal income tax purposes, its wellhead fair market value of OCS oil, less related costs and expenses. Shell also excluded OCS property, OCS payroll and a wellhead fair market value of OCS oil from the denomi-

nators of the property, payroll and sales factors of the apportionment formula contained in §214.71, F.S., as modified by §220.15, F.S.

7. For federal income tax purposes, Shell Oil expenses (i.e., writes off for the current year) intangible drilling costs.

8. In its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil included all costs of its offshore oil wells, including intangible drilling costs, in the property fraction of the Apportionment Formula.

9. During my audit of Shell Oil, I restored the fair market value, at the wellhead, of OCS oil to the sales factor for the apportionment formula. While adjusting the sales factor, I mistakenly added the OCS property and payroll "values" to the property and payroll factors.

Upon review of my audit work papers by corporate income tax personnel this error was found. The Department of Revenue issued a corrected proposed audit deficiency on August 11, 1977.

_____

LARRY CHURCHILL

SWORN TO AND SUBSCRIBED BEFORE ME THIS 15th DAY OF September, 1982.

_____

Notary Public

My Commission Expires October 1, 1974.

Appendix 5

IN THE RECORD AS PART OF EXHIBIT H TO AFFIDAVIT OF J. L. KENNEDY

February 4, 1980

Shell Oil Company
One Shell Plaza
Post Office Box 2463
Houston, Texas 77001

Attention: J. O. Lewter, Manager
State Income Taxes

RE: Protest
Florida Corporate
Income Tax
Deficiencies
FEI: 13-129-9890
FYE: 12/31/72,
12/31/73, 12/
31/74 & 12/31/
75

Dear Mr. Lewter:

We are enclosing a revised report of the above referenced tax years which reflects the Department's revised determination of the correct income tax deficiencies for the years ending December 31, 1972 through 1975.

The revised report takes into account all the issues which were raised

in the taxpayer's protests dated February 4, 1977 and October 3, 1977, and in the taxpayer's letters of May 15, 1978 and November 6, 1979.

Among the concessions made to the taxpayer is the allowance of the 1975 excess statutory depletion over federal depletion in the amount of $277,141,895.00 and the allowances of capitalized royalties as set forth in your letter of November 6, 1979.

According to the audit report dated August 10, 1977, the 1975 capitalized royalties claimed per return amounted to $1,615,085,488.00 (thereby being over-stated by $82,314,016.00). This excess accounts for the difference between the capitalized rentals claimed on Line 5, Schedule III-C of the F-1120 and the amount allowed on Line 4, Schedule I C, page 15 of the revised report.

Since you already have in your

possession, the Department's letter dated April 19, 1977, in reply to your original protest, and the Department's letter of August 11, 1977, in response to the informal conferences (March 1, 1977 and July 21, 1977) it is considered unnecessary to elaborate on those audit adjustments that had been sustained in the original Notice of Decision.

Attention is invited to the Department's letters to Mr. Norman E. Rusch, dated July 20, 1979 and September 19, 1979, which set forth the Department of Revenue's final positions with respect to those issues that are peculiar to the oil industry. The letter of July 20, 1979, affirms the Department's positions that O.C.S. property and payroll, as well as the expended intangible drilling and development costs are not includable in the apportionment factors.

Finally, in response to the

supplemental protest filed by Mr. J. L. Kennedy, Tax Attorney, under date of October 3, 1977, the Department's positions with respect to designated "new" issues are stated as follows:

Issue IIA - Year Barred from Adjustment - 1972

We cannot agree that the statutory period of limitations has run as against the proposed assessment for the year 1972 as it relates to the adjustments discussed under Issues IIB and VI below.

Nor can we agree that the Department has enlarged such prior proposed assessments.

The facts that we have before us at this point in time indicate the following:

(a) That the 1972 Florida form 1120 was filed on September 24, 1973, pursuant to a timely requested extension date of October 1, 1973;

(b) That the normal statutory period for 1972 assessment of tax ran (because of the timely filed and granted extension) until three years from October 1, 1973, or until October 1, 1976;

(c) That the statutory period for the assessment of additional Florida corporate income taxes deemed due for the year 1972 had been timely extended to December 31, 1976, as of July 19, and 22, 1976;

(d) That the Florida Notice of Deficiency covering the year 1972, as well as the years 1973, 1974 and 1975, was issued to Shell Oil Company on December 14, 1976;

(e) That the Department's Notice of Decision relative to the years involved was issued under date of August 11, 1977; and,

(f) Finally, that our Notice of Decision

generated a request for reconsideration as filed on behalf of Shell Oil Company under date of October 3, 1977.

The above facts, particularly as tothe dates involved, tend to crystallize the pivotal considerations here regarding Section 214.09, Florida Statutes, and urge us to comments contra to those which have already been made (we believe erroneously) in the request for reconsideration.

Section 214.09(1)(a), Florida Statutes, requires the timely issuance of the Department's Notice of Deficiency within three years after the date that a particular return is filed.

In the instant situation, this condition has been appropriately satisfied since the Notice of Deficiency covering the year 1972 was issued on December 14, 1976, which date fell within the extended statutory period that termi-

nated on December 31, 1976. In this regard, we feel fully supported by the following language of Section 214.09(4), Florida Statutes:

> "If, before the expiration of the time prescribed in this section for the issuance of a notice of deficiency, both the department and the taxpayer have consented in writing to its issuance after such time, such notice may be issued at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon." *(Under-scoring added)

Upon the execution of a consent to extend the period in which a Notice of Deficiency may be issued (as was done in the instant case via the extension of the assessment date) the time for making any assessment is then further extended for the period in which the making of an assessment is prohibited and for 60 days thereafter. (Underscoring added)

This requirement is statutorily defined by the following provision of

Section 214.03(2) and 214.11(4), Florida Statutes:

> "Whenever a notice of deficiency has been issued, the amount of the deficiency shall be deemed assessed on the date provided in s. 214.08 if no protest is filed or, if a protest is filed, on the date when the decision of the department with respect to the protest becomes final, as provided in s. 214.11(4)."
>
> "The decision of the department on any taxpayer's protest shall become final 60 days after issuance of a notice of decision under subsection (2) unless a timely request for reconsideration was made under subsection (3), in which case the decision shall become final upon the issuance of a notice of denial of such request or the issuance of a notice of decision on reconsideration." (Underscoring added)

Consistent with all the above, it is the Department's position that the Notice of Deficiency was in fact, issued timely in accord with the cited Florida Statutes and because it was, so was our Notice of Decision dated August 11, 1977.

In view of this established timeliness any amendment to the 1972 Florida

corporate income tax as reflected in the Notice of Deficiency dated December 14, 1976, were proper and not the result of "new issues" but rather an affirmation of our consistent position regarding the Outer Continental Shelf (O.C.S.) aspects already reported to Shell Oil Company and identified in both its protest and request for reconsideration as Issues I, II and III.

Issue IIB - Outer Continental Shelf Property and Payroll

Apropos of the above, we do not regard this particular issue as "new". We do, however, feel that remarks supplementing those as reflected on page five of our Notice of Decision dated August 11, 1977, should issue at this time and thus serve as a reply to the additional points raised regarding O.C.S. property and payroll in the request for a reconsideration.

At first blush it would appear that since the Department of Revenue is attempting to tax the income from Shell Oil Company's O.C.S. oil production that in deference to basic equity it should permit the inclusion of O.C.S. property and payroll values in the factoring denomintors of the years being contested.

Such a simplistic proposition would have to receive some sort of recognition if it squared with the facts which it does not since Florida is not taxing O.C.S. income but is taxing the ultimate sales of such production after it is piped, barged or boated to domestic refinery facilities.

In short, such sales, based on the facts presently before us, are non-severable from total sales domestically, and even if they were, our view is that they would still be domestic and not foreign sourced since the O.C.S. to date

has not been identified as being other than part of the total United States (as was Puerto Rico in the Heftler Construction Company case.)

This being the situation then such sales are beyond the relief afforded by Section 220.13(2)(b), Florida Statutes. In short, such sales clearly are not "foreign situs".

This we believe is the prime dispositive consideration which severs the need to consider our proposed taxing of O.C.S. income and our denial of property and payroll values in the factoring denominators as being related.

Having eliminated the alleged tie between the proposed O.C.S. sales adjustments and the property and payroll exclusions, we now address additional remarks to these latter aspects which support the position we have already taken on page five of our Notice of Decision.

We do not agree that our exclusion of property and payroll values from factoring denominators is in violation of the provisions in 43 U.S.C.A.1333(a)(2). Indeed, we believe that our position defers to this federal statute.

In this regard, Section 220.15(3), Florida Statutes, provides that:

> "The term 'everywhere' in part IV of chapter 214, which is used in the computation of apportionment factor denominators, shall mean 'in all states of the United States, the District of Columbia, or any political subdivision of the foregoing'; and"

Furthermore, the following language of 43 U.S.C.A. 1332(a) clearly precludes any claim of ownership or possession by any state in O.C.S. lands:

> "It is declared to be the policy of the United States that the subsoil and seabed of the Outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control, and power of dispostion as provided in this subchapter."

This being the case then it appears that the Department is precluded from the

inclusion of O.C.S. property and payroll in factoring denominators because of the language of 43 U.S.C.A. 1333(a), which identifies such property and payroll as having a United States but not a Florida situs and thus places such values beyond the reach of Section 220.15(3), Florida Statutes.

This premise has been strengthened and the validity of the Outer Continental Shelf Lands Act itself recognized by the United States Supreme Court (95 S.Ct. 1155-1975) in its decision of March 17, 1975, which set to rest all previous state claims of ownership of O.C.S. lands when it ruled that the United States and not contiguous coastal states, had sovereign rights over both the seabed and subsoil of the Shelf.

Consistent with all the above, we reaffirm the exclusion of the O.C.S. property and payroll values from the

factoring denominators in each of the years 1972, 1973, 1974 and 1975.

In reply to your Issue V of the protest dated October 3, 1977, it is the Department's position that the dictates of Section 220.15, Florida Statutes, as quoted below, should be followed in computing the formulary apportionment as prescribed by Section 214.71, Florida Statutes.

> "220.15 Apportionment of adjusted federal income.-Adjusted federal income as defined in s.220.13 shall be apportioned to this state in accordance with part IV of Chapter 214, and for the purpose of applying said part to this code:...
>
> "(4) In lieu of the equally weighted three-factor apportionemnt fraction based on property, payroll and sales which is described in s. 214.71, there shall be used for purposes of the tax imposed by this code an apportionment fraction composed of a sales factor representing 50 percent of the fraction, a property factor representing 25 percent of the fraction, and a payroll factor representing 25 percent of the fraction."

On the other hand, if it is found

that the taxpayer is paying tax on an excess of 100% of federal taxable income, due consideration will be given to an application for relief under Subsection 220.15(4)(a), Florida Statutes, as prescribed below:

> "However, upon application in accordance with paragraph (a), any taxpayer shall be entitled to a refund of tax, in the amount determined under paragraph (b), if it can establish that the aggregate amount of its net income subject to tax under this code and in all other states for the taxable year exceeds 100 percent of the taxpayer's taxable income, as determined for federal income tax purposes, for the taxable year.
>
> "(a) Any taxpayer eligible for a refund under this subsection shall make application therefore in accordance with procedures set forth in part I of chapter 214. All applications for refund under this subsection shall be accompanied by a copy of the taxpayer's federal income tax return for the taxable year, copies of every return filed by the taxpayer in the states in which it has conducted business for the taxable year, and verification in the form of cancelled checks or other receipts of the taxpayer's payments of the amounts shown to be due on the several returns filed with the refund application."

"(b) The refund to which any taxpayer shall be entitled under the subsection shall be equal to 5 percent of the lesser of:

"1. The excess of the amount subject to tax for the taxable year under this code over the amount which would have been subject to tax if the taxpayer had computed net income for purposes of this code on the basis of the apportionment fraction described in s. 214.71; or

"2. The excess of the aggregate amount of net income subject to tax in Florida and in all other states for the taxable year over the amount of federal taxable income for the taxable year.

"(c) For purposes of this subsection, the terms 'net income subject to tax' and 'amount subject to tax' shall mean the amount against which a rate or rates are applied in determining the taxpayer's dollar liability for tax in any jurisdiction."

Issue VI - Mechanical Errors

The points raised in your request for reconsideration, relative to various mechanical errors in the computations, forwarded to you as part of the Department's transmittal dated August 11, 1977, have all been found valid and appropriate corrections are now reflected

on each DOR 802 in the revised audit report enclosed.

If you now agree, please complete the enclosed form DOR-870 and return it to this office. If you do not agree, please note the appeal options described at 2.b. on the form DOR-890 also being forwarded.

Your cooperation in this matter will be greatly appreciated.

Sincerely,

George J. Yore
Tax Conferee
Disposition Section

GJY/pm
Enclosures

Appendix 6

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-897

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA.

Defendant. /

MOTION TO AMEND

Plaintiff Shell Oil Company moves the court for leave to amend its Amended Complaint in this case to delete paragraphII of the prayer for relief contained on page 7 of the Amended Complaint.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S. Mail to Thomas L. Barnhart, Assistant Attorney General, Department of Legal Affairs, The Capitol, Room LL04, Tallahassee, Florida 32301, attorney for Defendant, this 23rd

day of February, 1983.

Robert B. Glenn, Jr. of
HOLLAND AND KNIGHT
Post Office box 1288
Tampa, Florida 33601
(813) 223-1621
Attorneys for Plaintiff

133930001Smot1:69

Appendix 7

IN THE CIRCUIT COURT OF
THE SECOND JUDICIAL
CIRCUIT, IN AND FOR LEON
COUNTY, FLORIDA.

SHELL OIL COMPANY,

Plaintiff,

vs. CASE No. 80-987

DEPARTMENT OF REVENUE
STATE OF FLORIDA

Defendant. /

DEFENDANT'S INITIAL INTERROGATORIES
TO PLAINTIFF

Omitted through 28

29. (a) Does Plaintiff sell any of the products from its OCS production operations to purchasers not affiliated with Plaintiff in sales which take place outside the 50 states and District of Columbia?

Yes, the Plaintiff sells some of its oil and gas production to independent purchasers on the OCS, which is outside the 50 states and District of Columbia.

(b) Where are these sales made (i.e., at the wellhead, in foreign ports?

They are made at or near the off-shore wellhead.

(c) What percentage of Plaintiff's total OCS production (in barrels, cubic feet, etc.) was sold in the sales described in interrogatory 29(a) for each year in controversy?

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

Note: These percentages were computed by reference to dollar values, not volumes. The information needed to answer on a volume basis was not readily available. If this information will not serve the immediate purpose, please so advise.

Omitted 30 through 35.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

David K. Miller
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, Room LL04
Tallahassee, Florida
(904)487-2142
COUNSEL FOR DEFENDANT

I HEREBY CERTIFY that the foregoing answers are true and correct, to the best of my knowledge, information and belief .

For Plaintiff B. G. Weir
Tax Officer

STATE OF TEXAS
COUNTY OF HARRIS

B. G. Weir, being duly sworn, deposes and says that the attached Answers to Defendant's Initial Interrogatories to Plaintiff are true and correct to the best of his knowledge, information and belief.

Sworn to and subscribed before me this 30th day of September, 1980.

Notary Public
My Commission Expires
November 17, 1981

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the original of the foregoing Defendant's Initial Interrogatories to Plaintiff and Answers thereto was mailed to the Clerk of the above-styled court for filing and copy of same was mailed to David K. Miller, Assistant Attorney General, this 3rd day of October, 1980.

_____

Attorney for Plaintiff

Appendix 8

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY

Plaintiff

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA

Defendant.
_____/

SHELL OIL COMPANY'S
MOTION FOR SUMMARY JUDGMENT

Plaintiff Shell Oil Company ("Shell") moves the court for summary judgment in its favor and against Defendant Department of Revenue of the State of Florida (the "Department") on the grounds that the pleadings and answers to interrogatories filed in this case and the affidavits attached to this motion show that there is no genuine issue as to any material fact and that Shell is entitled to judgment as a matter of law. The following are the more

specific grounds upon which this motion is based and the substantial matters of law to be argued.

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") violates the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. If Shell's income derived from its production business on the OCS should be included in Shell's net income for Florida income tax purposes, such income should be apportioned to Florida by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula"), or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in denominators of the Apportionment Formula.

3. The Department unlawfully refused to allow Shell to include all of its original cost of oil and gas wells, particularly its intangible drilling and development costs in the property fraction of the Apportionment Formula.

4. The Department's audit, upon which its assessment are based, contains a mathematical error in the calculation of the property factor of the Apportionment Formula for 1974, causing an overstatement of Shell's tax liability by $5,504.00.

5. A portion of the Department's assessment for 1972 is barred by the applicable statute of limitations.

Robert B. Glenn, Jr. and
Stanley W. Rosenkranz, of
HOLLAND AND KNIGHT
Post Office Box 1288
Tampa, Florida 33601
(813)223-1621
Attorneys for Plaintiff

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing motion for summary judgment has been furnished by U.S. Mail to E. Wilson Crump, II and David K. Miller, Assistant Attorneys General, Department of Legal Affairs, The Capitol, Room 1104, Tallahassee, Florida 3301, attorneys for Defendant, this 2nd day of October, 1981.

_____

Robert B. Glenn, Jr.

AFFIDAVIT OMITTED

Appendix 9

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA.

Defendant. /

AMENDMENT TO MOTION FOR SUMMARY JUDGMENT

Plaintiff Shell Oil Company amends its motion for summary judgment previously filed in this case to delete paragraph 2 of the motion and the grounds stated therein. Plaintiff does not intend to abandon the grounds set forth in paragraph 2 for all purposes but withdraws such grounds for purposes of its motion for summary judgment.

I HEREBY CERTIFY that a copy of the foregoing has been furnished by hand delivery to Thomas L. Barnhart, Assistant Attorney General, Department of Legal

Affairs, The Capitol, Room LL04, Tallahassee, Florida 32301, Attorney for Defendant, this 19th day of November, 1982.

Robert B. Glenn, Jr., of
HOLLAND & KNIGHT
Post Office Box 1288
Tampa, Florida 33601
(813) 223-1621
Attorney's for Plaintiff

Appendix 10

IN THE CIRCUIT COURT
OF THE SECOND JUDICIAL
CIRCUIT, IN AND FOR
LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE No. 80-987

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Defendant. /

DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT

Defendant, Department of Revenue, State of Florida, ("Department") moves this court for summary judgment in its favor and against Plaintiff Shell Oil Company ("Shell") on the grounds that the pleadings and answers to interrogatories and the affidavits filed in this case show that there is no genuine issue as to any material fact and that the Department is entitled to judgment as a matter of law. The following are the more specific

grounds upon which this motion is based and the substantial matters of law to be argued:

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") does not violate the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. The Department cannot lawfully allow Shell to include property located on the OCS and compensation paid to employees on the OCS in the denominators of the property and payroll factors of the apportionment formula pursuant to §214.71, F.S., as modified by §220.15, F.S.

3. Shell should not be allowed to include its intangible drilling and development costs in the property fraction of the Apportionment Formula.

4. The Department's assessment for

1972 is not affected by the applicable statute of limitations.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

Thomas L. Barnhart
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, LL04
Tallahassee, FL 32301
(904) 487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT has been furnished by hand on the 19th day of November, 1982 to ROBERT B. GLENN, Jr., Esquire, P.O. Box 1288, Tampa, Florida 33601.

Thomas L. Barnhart
Ass't Attorney General

Appendix 11

In the Supreme Court of Florida

Shell Oil Company, Petitioner	)	
v.	)	Case Nos. 66,240 66,254
Department of Revenue, Respondent.	)	

On Review from the District Court of Appeal, First District

Petitioner's Initial Brief

Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
P. O. Box 2463
Houston, Texas 77001
(713) 241-2414

Arthur J. England, Jr., Esq.
Sandra S. Barker, Esq.
Fine Jacobson Schwartz Nash Block & England, P.A.
2401 Douglas Rd.
Miami, FL 33134
(305) 446-2200

PAGES 1 - 4 OMMITTED

Shell has invoked the Court's discretionary jurisdiction, on the basis of the district court's certified question, in order to obtain a declaration that the exclusion of all Outer Continental Shelf income from Florida's income tax is required by Florida and federal law. As to the apportionment issue discussed in the district court's opinion, which involves only how much of the income earned by a multi-state enterprise may be attributed to Florida as opposed to what items actually compose the amount of taxable income itself, Shell believes the district court has mistakenly sanctioned an unconstitutional distortion of

Florida's apportionment formula.[4] That is, the court has allowed the formula for attributing to Florida a portion of Shell's nationwide business activities to skew Florida's share in a way which affronts the United States Constitution and federal law. To avoid confusion on the important "exclusion" issue, however, Shell elects not to argue the apportionment issue before the Court.

PAGES 6 - 33 OMMITTED.

---

[4]The appropriate correlation of includable income items, and the formula for apportioning that income to Florida, was identified in Heftler Construction Co. v. Department of Revenue, 334 So.2d 129 (Fla. 3d DCA 1976), cert. denied, 341 So.2d 1082 (Fla. 1977). Cf. Continental Illinois National Bank & Trust Co. v. Lenckos, 464 N.E.2d 1064 (Ill.), cert. denied, 105 S.Ct. 296 (1984); see also Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983), describing the necessity for an apportionment formula which contains both internal and external consistency.

Certificate of Service

I certify that a true and correct copy of this brief was mailed on March 4, 1985 to Joseph C. Mellichamp, III, Esq., Assistant Attorney General, Department of Legal Affairs, The Capitol, Tallahassee, Florida 32301, counsel for the Department of Revenue.

Arthur J. England, Jr., Esq.
Sandra S. Barker, Esq.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

Appendix 12

IN THE SUPREME COURT OF THE

STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240 and 66,254

DEPARTMENT OF REVENUE,

Respondent.

_____/

Motion for Rehearing

Pursuant to Rule 9.330, Fla. R. App. P., and the order of the Court extending the time for rehearing until May 20, Shell Oil Company moves for rehearing and requests that the Court reconsider its decision of April 24, 1986. Shell respectfully suggests that:

(i) with respect to the issue of intangible drilling costs (IDCs), the Court has both overlooked a decision of the Oregon Supreme Court which has reversed an Oregon tax court decision on

which the Court has relied, and it has misapprehended the effect of the treasury regulation on which the Court has relied; and

(ii) the Court has overlooked an unconstitutional consequence of now holding that the state in this case may tax net revenues derived from Shell's production of oil and gas on the Outer Continental Shelf (OCS).

As to IDCs

1. The Court has held that IDCs which are expensed for federal income tax purposes, rather than capitalized, may not be included in the property factor of the state's apportionment formula. Some of the reasons offered by the Court actually seem to be at odds with the result reached on the basis of those reasons. The bases for the Court's determination seem to be three:

(a) that Shell elected to expense

IDCs, and "thereby voluntarily subjected itself to the restriction of treasury regulation section 1.1016-2" (Shell Oil Co. v. Department of Revenue, 11 F.L.W. 186 (Fla. April 24, 1986);

(b) consistency with other states as reflected in decisions of the tax court of Oregon and an agency in California (id.); and

(c) the district court's disregard of both the Department's regulation (12C-1.15(4)(b)(5)) and a statute (section 220.42(1)) which requires consistency between state and federal methods of accounting (id.).

(a) expensed IDCs. The Court has cited treasury regulation 1.1016-2(a) (1957) for the proposition that expensed IDCs do not give rise to a basis adjustment. Shell would note that neither party cited or referenced this regulation in its briefs, in all

probability because the regulation bears on the computation of tax basis rather than the wholly different concept of attributing income among multiple taxing jurisdictions by means of an apportionment formula. The two subjects are unrelated. See Shell's reply brief at pages 16-19.

Should the Court choose to rely on this regulation, however, Shell suggests that the Court's analysis of the regulation is accurate but respectfully notes that the regulation supports Shell's treatment of IDCs, rather than the Department's. Yet the Court has held for the Department on this issue.

The unadjusted tax basis of property, such as would be required for expensed IDCs under the regulation which the Court has identified, is original cost. Section 214.71(1)(a), Florida Statutes. Shell in fact treated IDCs on

its Florida tax return at original cost, and has asserted that to be the proper basis in its argument to this Court. The federal regulation referenced by the Court supports Shell's treatment of IDCs. If Shell has voluntarily subjected itself to this regulation, as the Court has stated, it should prevail on this issue.

(b) consistency. The Court has stated it wishes to be consistent with other states in the treatment of IDCs for apportionment purposes. Shell agrees that Florida should be consistent with other states. The Court has misapprehended the position of the other states on IDCs, however.

The Oregon tax court decision which was relied on by the Court on this issue was reversed by the Oregon Supreme Court on April 1, 1986. A copy of the Oregon decision, entitled Atlantic Richfield Co.

v. Department of Revenue, was filed with the Court, without argument, in Shell's Notice of Supplemental Authority dated April 4, 1987.* Undoubtedly the decision of the Oregon Supreme Court was simply overlooked by the Court when the decision in this case was released.

The Oregon Supreme Court, like this Court, predicated its decision on uniformity and consistency among the states. The Oregon high court identified several states that treat IDCs for apportionment purposes in the manner that Shell has proposed -- states not mentioned by this Court in its opinion. The Oregon Supreme Court concluded its analysis by stating:

---

* Shell would call to the court's attention that a petition for rehearing is presently pending before the Oregon Supreme Court.

> In order to meet the UDITPA "uniformity" criterion, we hold that IDCs should be included in "original cost." (Slip opinion at page 14.)

Consistency with other states on the treatment of expensed IDCs also requires that Shell prevail on this issue.

(c) district court errors. In reversing the district court as to IDCs, the Court has stated that the district court ignored both the original cost regulation, Rule 12C-1.15(4)(b)(5) as promulgated by the Department, and section 220.42(1), Florida Statutes. Clearly, there is some confusion here. The district court did not ignore the original cost regulations. In ruling for Shell on this issue it followed, indeed relied on, Rule 12C-1.15(4)(b)(b)(5).

> Shell's procedure conforms to the Department's rule. (Shell Oil Co. v. Department of Revenue, 9 F.L.W. at 770 (Fla. 1st DCA 1984).

It was the Department which had argued against the Rule, by suggesting to the district court that it is not applicable to IDCs. If the Rule is not to be ignored, as the Court implies, this is yet another reason that Shell should prevail on this issue.

The Court has also apparently misapprehended section 220.42(1)'s application to this proceeding when it declared that it provides a "clear mandate" for the exclusion of IDCs from the property factor of the apportionment formula. By its express terms, section 220.42(1) was enacted and applies only "for purposes of the income tax code" -- to wit, chapter 220, Florida Statutes. Apportionment is not determined by the income tax code. It is prescribed in chapter 214, Florida Statutes, entitled "Administration of Designated Nonproperty Taxes." It would seem that the Court

confused accounting requirements for computing a taxpayer's income under the income tax code, with the non-accounting determination of property factors in the formula for administering various tax laws.

As to OCS production income

2. Based on the "realization" of taxable income at the time refined oil products are sold in the United States, the Court has approved the district court's decision to the effect that the OCS Lands Act ddoes not bar the State of Florida from taxing Shell's OCS production income. In so doing, however, the Court has inadvertently abridged the constitutional limitations on state income taxation which are set forth in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983).

Florida has now taxed all of Shell's net income, including that derived from

production activities on the Outer Continental Shelf. But Florida's apportionment formula has not taken into account the payroll or property Shell expended in the course of producing OCS income. Those enormous sums are simply disregarded, as if no money had been used in extracting oil and gas from beneath the sea. See Shell Oil Co. v. Department of Revenue, 9 F.L.W. 769 (Fla. 1st DCA 1984). That is the situation this Court has now approved, and therein lies the problem.

A brief explanation of the difficulty is necessary, as the problem was not manifest before the Court's decision.* Consequently, no prior analysis has been given. The Court may find it helpful to order additional briefs on this issue.

---

* In its initial brief, Shell mentioned this difficulty. (See

Container's mandatory tests for internal and external consistency are met in only one of two ways. Either a state must accord separate accounting treatment to OCS income, by "backing-out" OCS income to reflect the mandate of section 1333(a)(2), or a state must apply a constitutionally fair apportionment methodology with respect to multistate net income by providing so-called "factor relief" in the apportionment formula.

---

* Continued.

page 5.) Shell's contention that OCS production income is excludable from the tax base made discussion of the district court's defective apportionment unnecessary. The fact that Shell chose not to discuss the apportionment issue, for ease of argument, did not eliminate the constitutional difficulty. Now that the Court has placed its stamp of approval on the district court's opinion (see Shell Oil Co. v. Department of Revenue, 11 F.L.W. at 186 (Fla. April 24, 1986), Shell would be remiss if it did not advise the Court that it has sanctioned an unconstitutional methodology for state income taxation.

Shell had urged the first approach by asking the Court to exclude OCS production income from Shell's tax base, but the Court has rejected that position. The consequence of that rejection is approval of the district court's tax levy on a distorted, and unconstitutionally skewed apportionment methodology.

Formula apportionment is the method commonly used to divide the income of a unitary business among various jurisdictions in which the business operates. This was the method used by the Florida Department of Revenue in this case. The formula method, "unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted

within the taxing State." Moorman Manufacturing Co. v. Bair, 437 U.S. 267, 273 (1978).

The formula method assumes that the total income of a business enterprise results from certain income-producting factors -- typically property, payroll and sales. The value of the corporation's property, payroll and sales within the taxing state is compared to the value of those factors everywhere -- both inside and outside the taxing state. The resulting ratio is then applied to the taxpayer's total apportionable net income.

A state, of course, cannot arbitrarily choose a formula by which to apportion income. The chosen formula must be judged to be fair under the tests articulated in the Container decision. The tests of Container are referred to by that Court as the internal and the

external consistency tests. Container Corp. of America v. Franchise Tax Board, 463 U.S. at 169.

(a) internal consistency. This test was originally established as the uniform application rule in Moorman Manufacturing Co. v. Bair, 437 U.S. 267 at 276-277 and n. 12. It was restated as a rule of internal consistency in the Container decision (463 U.S. at 169):

> (T)he formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed.

The rule of internal consistency is complicated and technical. The tax method approved by the Court for application to Shell's income does not meet the internal consistency test. Unfortumately, it would require a rather lengthy explanation and set of examples to explain why. As this motion is not the place for that type of analysis, further

briefing of the issue would seem appropriate.

(b) external consistency. This test of the required fairness in an apportionment of taxable income is also set out in Container (463 U.S. at 169):

> the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

The Court's application of the Florida formula against Shell's income flunks this test.

The Court has sanctioned a result which says, in effect, that there have been no applications of property or payroll on the OCS which contributed to the generation of Shell's income. Florida's formula, of course, recognizes that income is attributable to other locales in which payroll and property are present. By pretending that Shell expended no payroll and used no property

to generate OCS revenues, Florida over-attributes income to itself in a way which violates the external consistency test of Container.

WHEREFORE, Shell respectfully requests that the Court reconsider its April 24 opinion and decision for the reasons expressed. As the Court may find further oral argument to be helpful, Shell has filed a motion requesting same. Shell also stands ready to provide additional briefing on these issues.

Respectfully submitted,

Wm. D. Peltz,
Sr. Tax Counsel
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Co.
P. O. Box 2463
Houston, TX 77001
(713) 241-2414

Arthur J. England, Jr., Esq.
Fine Jacobson Schwartz Nash Block & England P.A.
2401 Douglas Rd.
Miami, Florida 33134
(305) 446-2200

Certificate of Service

I certify that true and correct copies of this motion were mailed on

May 19, 1986 to Joseph C. Mellichamp, III., Esq., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

By: _____

Appendix 13

IN THE SUPREME COURT

OF THE STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. CASE NOS. 66,240 & 66,254

DEPARTMENT OF REVENUE,

Respondent.
_____/

RESPONSE TO MOTION FOR REHEARING

Shell Oil Company ("Shell") moved for rehearing and requested this Court reconsider its decision of April 24, 1986 rendered in this cause. This Court by order extended the time for filing response of the Department of Revenue ("Department") to June 4, 1986. The Department responds hereby and respectfully urges this Court to deny Shell's motion for the reasons that this Court's standing decision is precisely

correct (as explained hereinafter) but rather each of Shell's recitations of error alleged as inherent in that decision are fatally flawed.

As stated by Shell in its motion:

Shell respectfully suggests that:

> (i) with respect to the issue of intangible drilling costs (IDC's), the Court has both overlooked a decision of the Oregon Supreme Court which has reversed an Oregon tax court decision on which the Court has relied, and it has misapprehended the effect of the treasury regulation on which the Court has relied; and
>
> (ii) the Court has overlooked an unconstitutional consequence of now holding that the state in this case may tax net revenues derived from Shell's production of oil and gas on the Outer Continental Shelf (OCS).

AS TO IDCS

OMITTED THE TEXT OF THIS TOPIC.

AS TO OSC PRODUCTION INCOME.

For the sake of precise organization of this response, the Department used

Shell's heading which references "production income." But, at the outset, the Department must note its objections to Shell's continued use of an artificially created term "production income," a concept which is a self-created and self-deceiving illusion, which is totally non-existent under federal or state income tax laws. To finally dispense with this illusion, as to the existence of "production income" assume one altered fact situation from that in the Shell record. Assume that while Shell produced all oil on the OCS as evidenced, instead of selling same, Shell merely physically retained possession of the oil as inventory stored anywhere on this earth and did nothing further. It is respectfully submitted that under the federal Internal Revenue Code and under the accounting conventions which underlie any federal tax accounting

BEST AVAILAB

method authorized thereunder, no amount of "income" would be recognized or realized nor would be reportable in the year of extraction. Thus, "production income" is "phantom income" and is nonexistent under the federal code.

The business activities which are nomenclated as "production" are conecedly such that, under federal law, the value of the oil produced which is held in inventory includes the costs attendant to production activities. The business activity which must take place to give rise to any amount of "income" is the activity of making sales. The various states of the United States found their respective ability to tax a respective share of the income arising from such sales upon the fact that such sales are consummated within the jurisdiction of these various states. As this Court correctly decided as to the principal

BLE COPY

issue, the federal preemptive statute operates to restrict the jurisdictional limit of states continguous (sic) to international waters to the 3 mile, not the 10 mile limit.

To compute the income derived from such sales activity, costs incurred in the process of production (extraction on the OCS in the Shell circumstance) are deducted from the sales price to determine the gross profit. Thus, for the determination of the tax base, the cost of production (extraction), not the artificially computed value of the goods measured at the time and place of production (production income) is used to prescribe the offset against the proceeds of any subsequent sale. If Shell's concept of deducting its artifically computed "production income" from the subsequent sales price is followed, its gross profit would be zero or at best

hardly more than the transportation costs which provide subsequent place utility. The expenses attendant to the sales activity are deducted from gross profit. In any event, Shell's "production income" based on "market value" at the wellhead grossly exceeds the "cost of production" else the well would be shut down.

Thus, for income determination purposes, Shell's OCS "production costs" have been fully accommodated. Shell next complains that the same is not true for apportionment purposes.

The precise statement of Shell's second complaint is:

* * * * *

> 2. Based on the "realization" of taxable income at the time refined oil products are sold in the United States, the Court has approved the district court's decision to the effect that the OCS Lands Act does not bar the State of Florida from taxing Shell's OCS production income. In so doing, however, the Court has inadvertently

abridged the constitutional limitations on state income taxation which are set forth in Container Corporation of America v. Franchise Tax Board, 463 U.S. 1659 (1983).

Florida has not taxed all of Shell's net income, including that derived from production activities on the Outer Continental Shelf. But Florida's apportionment formula has not taken into account the payroll or property Shell expended in the course of producing OCS income. Those enormous sums are simply disregarded, as if no money had been used in extracting oil and gas from beneath the sea. See Shell Oil Co. v. Department of Revenue, 9 F.L.W. 769 (Fla. 1st DCA 1984). That is the situation this Court has now approved, and therein lies the problem ....

Shell had urged the first approach by asking the Court to exclude OCS production income from Shell's tax base, but the Court has rejected that portion. The consequence of that rejection is approval of the district court's tax levy on a distorted, and unconstituionally skewed apportionment methodology.

From the foregoing, Shell concedes, arguendo, that while the issue as to the

income determination made addressed by both the district court and by this Court was resolved correctly against Shell, such resolution thereby inadvertently created an unconstitutional distortion as to the corollary apportionment determinations which underly the contested Florida levy.

To provide a proper frame of reference, it is critical to note that in pressing its argument in respect of alleged distortive apportionment fractions, Shell has again shifted gears. It switched from referencing "production income" to referencing what is best nomenclated as "costs of production," such "costs of production" being those incurred on the OCS.

Next, there were two fundamental issues which stem from the initial judicial proceedings which survived to reach possible consideration by the

Florida Supreme Court, namely:

1. Whether this Department improperly included "OCS income" (however defined) in Shell's preapportionment tax base in controvention of a federal preemption, and

2. Whether the Department improperly excluded IDCs from the construction of the property fraction for apportionment purposes.

Based upon a relatively recent decision uttered by the United States Supreme Court, Shell lacks standing at this point to raise the question as to the possible existence of constitutional limitations in respect of the resultant basic apportionment formula, because Shell voluntarily waived and abandoned the apportionment issue (except as to the lesser included exclusion of the IDCs from the construction of the property fraction) early on and repeatedly in the

course of this litigation. Next Shell's insistence that the introduction of "cost of production" into the Florida three-fraction formula is mandated by constitutional provision is absolutely contrary to a recent U.S. Supreme Court decision directly on point.

Further, in response to this issue, Shell has contemporaneously filed a Motion for Order Compelling Compliance with Court Decision under Fla. R. App. P. 9.300. This Motion is a mere extension of its Motion for Rehearing. No separate issues are raised that were not included in the Motion for Rehearing, therefore, the issues that were raised have been responded to in this Response to Motion for Rehearing.

It appears that the sole purpose of the additional motion was to utilize Fla. R. App. P. 9.300 which allows the includsion of "other supporting

documents" an option not available under Fla. R. App. P. 9.330, under which Shell seeks a rehearing. The letters which Shell attempts to place before this Court with its motion are the sole items added by it. A review of these letters shows that the Department has maintained a consistent position and that position is supported by both appellate decisions. The bottom line is that Shell still has no basis to raise this argument.

Shell, by its motion for an order to compel, attempts to raise an embryonic question of fact which it has repeatedly abandoned, that being whether Shell had actually consummated any sales upon the OSC, an issue answered by the Department with a denial. There is nothing in the record before this Court to show that Shell had attempted to perfect or had preserved this factual issue. Quite to the contrary, the district court at page

960 of its decision stated:

> Shell's primary issue is ... whether 43 U.S.C. s. 1333(a)(2)A, infra, prohibits Florida from taxing its income from the sale in the United States of Oil extracted from its outer continental shelf wells. We reject Shell's position that it does, for all of the oil from these wells was brought into the United States, refined in the United States, and then sold in the United States.

Further, in that decision, the district court, at page 961, stated:

> ... the income in Shell's case was realized totally from sales of oil in the various states of the United States.

The Department respectfully submits that this Court, while responding within the frame of reference of the question certified, at page 2 of its decision, stated:

> . . . Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.

> DOR contends that because Shell sold the oil within the boundaries of the fifty states, and not on the OCS, the taxable event occurred within the reach of Florida's tax laws. On the other hand, Shell contends that the time and location of the actual sale are irrelevant.. . . (e.s.).

It is clear from the existing decisions that the dispute in this case concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.e. (sic)

This observation is further supported by the letters which Shell attached to the motion. The Department calls this Court's attention to the letter dated May 15, 1986, addressed to Shell's counsel, which contains an attachment consisting of extracts of documents filed in an administrative proceeding in Iowa which clearly supports the Department's position that Shell had not consummated any sales of oil on the

OSC and lends additional insight as to the reasons therefore. Lastly, the Department's response to Shell's contentions is contained in the Department's letter response to Shell's counsel dated February 25, 1986, which accompanied Shell's Motion to Compel. Thus, the Department is in full compliance with the decision of this Court.

SHELL'S LACK OF STANDING AS TO THE CONSTITUTIONAL ISSUE.

There is no indication of Shell's objection to the omission from the apportionment factor of "cost of production" visible in either the Final Judgment entered by the trial court nor in the decision of the District Court of Appeals.

To fully compromise its standing as to this issue, Shell, in its initial brief to this Court,, at page 5 stated:

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (e.s.)

The utterance in respect of such an election made by the U.S. Supreme Court, completely dispositive of the issue as Shell now claims, arose in the case of another oil company.

The Shell situation compares directly to that Mobile once created for itself (see Mobil Oil Corp. v. Commissioners of Taxes of Vermont), 63 L.Ed.2d 510, 519 (1980). The U.S. Supreme Court noted in that decision that:

> In keeping with its litigation strategy, Appellant has disclaimed any dispute with the accuracy or fairness of Vermont's apportionment formula. See Juris Statement 10, Brief for Appellant II. Instead, it claims that dividends from a "foreign source" by their very nature are not apportionable income. This election to

> attack the tax base rather than the formula substantially narrows the issues before us. In deciding this appeal, we do not consider whether application of Vermont's formula produced a fair attribution of appellant's dividend income to that State. Our inquiry is confined ....
>
> (as) that precludes, as a constitutional matter, state taxation of that income by the apportionment method. Id. at page 519.

The lesser included question of the possible latent constitutional infirmity of the state's chosen apportionment method is waived where the taxpayer voluntarily elects to limit its attack by addressing solely the tax base.

Shell's voluntarily and self-initiated election made before this Court similarly precludes inclusion thereof in any consideration remaining within the question certified to this Court or in those raised on cross appeal, (the latter being limited to construction of a single

specified fraction of the three fraction formula).

However, leaving no stone unturned, the Department now addresses the question of whether the failure to introduce a fourth fraction ("cost of production") or to modify one of the three clearly established fractions ("sales", "payroll" and "property") to reflect "cost of production" precipitates invalidation of the apportionment factor being used due to constitutional considerations. This question has also been answered in the negative by the United States Supreme Court as hereinafter explained.

UDITPA was first promulgated in 1957. Under it, a three fraction apportionment factor was established which consisted of:

1. "sales" (income)
2. "payroll" (expense)
3. "property" (capital employed)

Thus, these three items related to business activities (used in combination) were the measurements deemed by the NCCUSL to adequately achieve what was perceived to be a fair geographic distribution of a share of a given taxpayer's income to each state among the various states.

These are the three specific business activities used in the construction of the Florida apportionment factor. One recognized authority, writing in 1963, included commentary as to "other factors" which had been used in the various states:

> OTHER FACTORS.--A few states employ factors which differ from the standard property, payroll, and sales factors. Wisconsin uses a "cost of manufacturing" factor; other states using the same or a similar factor include Alabama, Kansas, Oklahoma, and Tennessee. Georgia uses a property factor employing the ratio of finished goods

> inventory in the state to total finished goods. Arizona provides for the use of cost of manufacturing and purchases as factors, but in practice they are rarely employed.

Walter H. Beaman, Paying Taxes to Other States, the Ronald Press Co., 1963, at pp. 7-19.

Gradually, over a near term of years, formularly apportionment using the UDITPA three fraction formula emerged as predominant and the use of alternative formulas or fractions faded away. As Justice Powell noted in his dissent in Moorman Manufacturing Co. v. G. D. Blair, 57 L.3d 197, at page 211 (1978), ". . . 44 of the 45 other (than Iowa) States which impose corporate income taxes use a three-factor formula involving property, payroll, and sales ...." Thus, whether by direct adoption of UDITPA or by separate specific amendment as in Wisconsin, use of the "cost of

manufacturing" or the "cost of production" for geographic assignment of income by formularly apportionment is no longer apparent.

Shell now urges that an imperative exists under the constitution which mandates that an additional expense fraction or corollary accommodation be employed in formularly apportionment. The United States Supreme Court expressly disagrees. Again, in Moorman, supra, commencing at page 204, the majority stated, "Yet despite this impression, the (this) Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." In direct contradiction of Shell's construction of a constitutional imperative inherently impacting upon a State's choice of apportionment fractions, the Court sanctioned Iowa's use of its single fraction apportionment

factor - "sales" (income) formula to the total exclusion of all considerations related to either the expense or property. Without question, the total exclusion of the expense nomenclated as "cost of production" from its apportionment factor is an option which Florida has and can exercise with constitutional impunity.

Lastly, Shell cited the recent decision in Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) as somehow casting favorable light upon Shell's urgings. The Department notes that the Moorman decision focused upon the issue of proper construction of the apportionment formula used to assign the income of a given separate taxpayer. In contrast, the Container decision dealt with the determination of a single tax base for income tax purposes of a group of separate corporations, affiliated by

ownership, scattered worldwide and the relative consequence of the use of the "standard" UDITPA three fraction apportionment formula upon such base determination under the state "unitary" method. That decision actually cited Moorman, repeatedly, supra, with favor and provides little else of consequence here, other than sustaining state use of the "standard" UDITPA three fraction formula, which does not reflect "cost of production" while the income base includes income acknowledgly earned outside the taxing state's jurisdiction.

In Container, California applied the "standard" UDITPA apportionment formula which consisted of:

1. "sales" (income)
2. "payroll" (expense)
3. "property" (capital employed)

Paralleling the basic Florida version of these three UDITPA fractions, California

did not include. directly or indirectly, any reflection of the expense item nomenclated as "cost of production", regardless of where on this earth such costs were incurred (in or out of California's jurisdictional limits measured geographically). The United States Supreme Court by its ultimate conclusion in Container fully sanctioned application of this California apportionment formula (including total omission of the expense known as "cost of production") and that apportionment handling passed constitutional muster.

Shell's attempt to make capital by the use of its perceived latent defect in the Florida result, derived from esoteric analysis of rationale, is totally eviserated by the ultimate Container conclusion.

For the reasons expressed herein, which impeach each of Shell's arguments,

the Department urges this Court to deny all relief requested by Shell.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

Sharon A. Zahner
Assistant Attorney General
Department of Legal Affairs
Tax Section, Capitol Bldg.
Tallahassee, FL 32301
904/487-2412

ATTORNEY FOR RESPONDENT

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Response to Motion for Rehearing has been furnished by U. S. Mail to WILLIAM D. PELTZ, Senior Tax Counsel & ELIZABETH C. BURTON, Tax Attorney, Shell Oil Co., P. O. Box 2463, Houston, TX 77001 and ARTHUR J. ENGLAND, JR., Esq., 2401 Douglas Rd., Miami, FL 33134, this 4th day of June 1986.

Sharon A. Zahner
Assistant Attorney General

COMPOSITE EXHIBIT A OMITTED.

Appendix 14

IN THE SUPREME COURT OF THE

STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240 and 66,254

DEPARTMENT OF REVENUE,

Respondent.
_____/

Motion for Order Compelling Compliance with Court Decision

Shell Oil Company respectfully requests that the Court order the Department of Revenue to comply with the Court's decision in this case insofar as it excludes from taxation "actual sales consummated on the OCS oil platforms [which] are beyond the reach of Florida's taxing power as limited by section 1333(a)(2)." Shell Oil Co. v. Department of Revenue, 11 F.L.W. at 185 (Fla. April 24, 1986).

1. The Court has held that the amount in controversy between the parties does not include the revenues derived from actual sales of oil and gas which are consummated on OCS oil platforms. This legal determination was predicated on the Department's concession to the Court that there has been no attempt to tax revenue generated from actual sales on the OCS oil platforms. id.

2. The time for requesting rehearing of the Court's decision has expired. Fla. R. App. P. 9.330(a). The Department has not requested rehearing on the Court's confirmation of the Department's concession as to the exclusion of revenue from actual OCS sales.

3. In its computation of the proposed income tax assessment, the Department in fact did not exclude revenues derived from actual OCS sales.

This matter was called to the Department's attention immediately after its concession to the Court during oral argument, but the Department has not corrected its assessment. Attached to this motion are copies of letters exchanged between the parties relative to the Department's position with respect actual OCS sales, which Shell asserts were in the following proportions of OCS production revenue:

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

(See Shell Oil's reply brief at page 8, fn. 5.)

4. Shell can establish that the Department has in fact taxed actual sales on the OCS.

Wherefore, Shell respectfully requests that the Court direct the Department to comply with its concession, and the Court's decision, with respect to

the exclusion of revenues derived from actual sales on the OCS oil platforms in the above proportions. As the Department contests Shell's assertions in this regard, the Court may want to appoint a qualified person to serve as master to conduct an inquiry into the computation dispute and to report his or her findings to the Court.

Respectfully submitted,

William D. Peltz,
Senior Tax Counsel,
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
Post Office Box 2463
Houston, Texas 77001
(713) 241-2414

Arthur J. England,
Jr., Esq.
Fine Jacobson
Schwartz Nash Block
& England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

Certificate of Service

I certify that true and correct copies of this motion were mailed on May 19, 1986 to Joseph C. Mellichamp, III., Esq., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and

to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

BY: _____

May 15, 1986

Arthur England, Esq.
2401 Douglas Road
Coral Gables, FL 33134

RE: Shell Oil Co. v. Dept. of Revenue

Dear Mr. England:

Your letter of April 29, 1986 directed me to have the Department of Revenue revise its present assessment. The audit file does not contain any evidence that there were any sales by Shell Oil to independent third parties on the Outer Continental Shelf. The fact that there have been no sales consummated on the OCS is reinforced by the information contained on the attached page from a brief filed May 8, 1985 by the Department of Revenue in an administrative proceeding in Iowa. In the matter of Shell Oil Company v. Department of Revenue, Docket No. 82-157-2A-A (Iowa Department of Revenue). In

the exchange of correspondence with Elizabeth Burton, to which you make reference, Shell offered no evidence to substanticate its claim.

The letter to Ms. Burton dated February 25, 1986, a copy of which was furnished to you, contains the Department's response in the frame of reference of the case itself.

I would point out a possible legal remedy which you may have overlooked. Chapter 214, Fla. Stat., gives taxpayers one year from the date the tax was paid in which to file for a refund. If your client wishes to present evidence of the existence of sales on the OCS, it would have an opportunity to present it under this Chapter after the tax has been paid.

Sincerely,

JIM SMITH
ATTORNEY GENERAL

Sharon A. Zahner
Assistant Attorney General

SAZ:mr
Attachment
cc: Randy Miller
William Townsend
Ms. Burton

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

IN THE MATTER OF	*	
	*	
SHELL OIL COMPANY	*	BRIEF OF
One Shell Plaza	*	DEPARTMENT OF REVENUE
P.O. Box 2463	*	
Houston, Texas	*	
77001	*	
CORPORATE INCOME	*	DOCKET NO.82-157-2A-A
TAX ASSESSMENT	*	

Harry M. Griger
Special Assistant Attorney General
Hoover State Office Building
Des Moines, Iowa 50319
Tel: 515/281-5846

Attorney for Department of Revenue

business of which is the exploration for, and development, production, transportation, purchase, and marketing of oil and chemical products. These activities were engaged in by Shell, an

integrated oil company, and the income of Shell was earned by its unitary business operations. Stip., pars. 2 and 7, Exhibits A through F.

During years 1975 through 1980, Shell conducted the majority of its business activities as two separate operating internal divisions, labeled the Products Organization (Products) and the Exploration and Production Organization (E&P). Stip., par. 3. These internal divisions were functionally integrated in that all of Shell's production of crude oil was transferred by E&P to Products by intra-company transfer, recorded at posted industry prices, but no cash was paid, and the crude oil was either exchanged by Shell with other oil companies or used by Shell to refine or manufacture petroleum or related chemical products. Stip., pars. 3 and 4. Since Shell's production of crude oil was

insufficient to supply Shell's refining and manufacturing needs, Shell had to purchase crude oil from other producers, including purchases from producers on the outer continental shelf and from foreign sources. Stip., par. 4. Also, Shell's entire business activities benefited from an umbrella of centralized management and economies of scale. Stip., par. 7 and Exxon case cited therein.

During 1975-1980, Shell's principal business, within the state of Iowa, consisted of marketing oil and chemical products refined and manufactured by its Products Organization. There

February 25, 1986

Ms. Elizabeth C. Burton
Tax Attorney
Shell Oil Company
P. O. Box 2463
Houston, Texas 77252

Re: Shell Oil Company v. Department of of Revenue
#66,240, #66,254, Florida Supreme Court

Dear Ms. Burton:

Your letter of February 11, 1986 addressed to the Division Director, Division of Audits, Florida Department of Revenue, has been referred to me for response.

Your letter includes the following paragraph:

> "Ms. Zahner's statements are not representative of the treatment accorded Shell in this case. If the Department's position is to remove the income from the sales on the OCS from the tax base then we request it do so, adjust our assessment, and advise the court that the entire assessment is no longer at issue. If the Department's position is to not remove such income, as reflected

> in its 1972 - 1975 audit assessment, then we request that the Department file a notice with the Court that the Department's position was misrepresented by Ms. Zahner in oral argument and specifically correct her misstatements which are more numerous than those specifically set out above."

We respectfully do not agree that Ms. Zahner's cited statements (TR-15 and TR-16) made in oral argument are in any manner misstatements of the Department's position or such position was not applied, to the extent appropriate, in the Shell case. Rather, the conclusion your letter reaches is a misapprehended one founded upon misunderstanding or disregard of the progress of this controversy and litigation, including the underlying facts, as hereinafter explained.

At the outset, the Department's position referred to by Ms. Zahner must be fully stated.

The Department's position is that the net income from a "sale" consummated outside "everywhere" must be subtracted in determining adjusted taxable income for income purposes, and the gross receipts from such sale are similarly to be excluded for apportionment purposes. It is submitted that both determinations must be concurrently made. In effect, "separate accounting" is applied for both net income determination and apportionment determination purposes as both the income being divided and the gross receipts (sales) giving rise to such net income must be synchronized else distortion occurs. However, this position is not applicable where the Department finds no sales have in fact been consummated outside "everywhere." Further, this position is founded solely upon provisions of the Florida Income Tax Code and not upon possible pre-emption

attributable to a federal statute.

Next, there are two fundamental issues which stem from initial judicial proceedings which survived to reach possible consideration by the Florida Supreme Court, namely:

1. Whether this Department improperly included "OCS income" (however defined) in Shell's preapportionment tax base in controvention of a federal enactment, and

2. Whether the Department improperly excluded IDC from construction of the property factor for apportionment.

The balance of this response is limited to discussion of the first issue as stated herein.

In its Amended Complaint filed in the Circuit Court, Shell stated:

> "1. Shell explores for and produces oil and gas, refines same, and markets same (Para. 2).
> 2. Shell markets its products throughout the United States

(para. 4).
3. Part of Shell's net income was earned by its production business (para. 6).
4. Shell excluded income earned from PRODUCTION on the OCS in its Florida income tax returns (Para. 7)."

In its Florida returns for each year, Shell had substracted substantial amounts nomenclated as "Value of Production (OCS)." The Department construed this to be a computation of an amount without the requirement of an actual "sale" transaction. Only marketing requires an actual sale. This concept gave rise to Shell's statement (in its Motion for Summary Judgment) of the issue as:

> "1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ('OCS') violates the Outer Continental Shelf Lands Act, 43 U.S.C. 1333(a)(2)."

This is the source of the issue now pending decision before the Florida Supreme Court and is generically solely

an issue of law, founded upon contravention of a federal statute.

A potential issue of fact was also present in Shell's Amended Complaint. Paragraph 7 thereof states that consistent with the concept of production income, Shell had excluded "OCS sales" from the denominator of the sales fraction for each year. Further, questions of propriety of such inclusion therein aside, your letter correctly notes that the percentages of sales occurring were ressurrected on page 8 in Shell's Reply Brief to the Supreme Court. Shell had, in fact, filed answers to interrogations in which amounts of sales were claimed to have occurred at the wellhead, expressed as percentages of OCS production, not dollars.

As to the potential issue of fact, the Department's auditor restored amounts of "sales from OCS" (as claimed by Shell)

to the denominator of the sales fraction for each year for the reason that no amount of purported "sales" of tangible personal property were found to have been consummated (as contemplated by Florida law) at the wellhead.

In its Answer and Defenses to Amended Complaint, at Paragraph 6, the Department admits Shell's production activities on the OCS but denies that the earnings were attributable to such OCS production activities, but rather, that the income was attributable to the marketing activities which occurred in the 50 states and the District of Columbia.

Further, in Paragraph 9 of its answer, the Department specifically denied that Shell had substantial OCS sales.

The Department then anticipated a full-blown trial on the merits as to this

potential and clearly controverted factual issue, including an opportunity to cross-examine Shell's witnesses and present testimony of its auditor. Thus, prior to the filing of Shell's Motion for Summary Judgment, the controverted factual issue of whether any "sales" had been consummated on the OCS was clearly evident and clearly in controversy.

Shell chose to waive and abandon this controverted factual issue in its Motion for Summary Judgment by stating that "there is no genuine issue as to any material fact and that Shell is entitled to judgment as a matter of law." This is confirmed by Shell's statement of the legal issue therein as previously noted. Further, Shell's abandonment was wholly consistent with Shell's statement that the "tax may be correctly computed, once Florida and U.S. law are construed in this case..." as so stated in Paragraph

14 of its Amended Complaint. By Shell's act of abandonment of the controverted issue of fact, Shell denied to the Department any opportunity or obligation to prosecute and perfect its defensive position related to the controverted factual issue.

The trial court then denied Shell's Motion for Summary Judgment and found in favor of the Department on the legal issue related to production income. Further, Shell, by its Motion to Amend, withdrew its issue related to alleged improper construction of the denominator of the apportionment fractions by the Department which included "OCS sales." This was done prior to the summary judgment hearing. Logic alone demands that, thereby, Shell confirmed it had abandoned the factual issue related to the existence of "OCS sales" in determination of income.

The amounts labeled "Value of Production (OCS)" subtracted from income by Shell in its returns each year was many times greater than the amounts of claimed "OCS sales" restored to the respective sales fraction denominator by the auditor each year, and hence, cannot represent income attributable to any such "OCS sales." Thus, the dollar amounts underlying the surviving legal issue are not related to Shell's claimed "OCS sales."

The Final Judgment entered by the Trial Court, because Shell withdrew its issue as to apportionment, was by its terms specifically based upon the fact that all surviving issues had been decided on Summary Judgement. Necessarily, that Court thereby recognized and finalized Shell's abondonment (sic) of the controverted issue of fact as to the actuality of any

sales having been consummated on the OCS. Also note that Shell chose to perfect an appeal rather than pursue alternatives available in the Trial Court to reinstate or otherwise resolve the controverted factual issue.

The Appellate Court included references in its decision that "...all of the oil from these wells was brought into the United States, refined in the United States, and then sold in the United States." Further, that court stated that "...the sales...occurred in the various states of the United States defined as 'everywhere', outer continental shelf...do(es) not come within the parameters of 'everywhere,'...". It also stated "...the income in Shell's case was realized totally from sales of oil in the various states of the United States." (Emphasis Supplied) Doubtless, these

statements are at least in part attributable to Shell's decision not to prosecute and resolve the controverted factual issue in the Trial Court.

The Appellate Court, responding to Shell's request, certified a question to the Florida Supreme Court, namely:

> "Whether the State of Florida is Prohibited By 43 USC #1333(a)(2)(A) From Imposing a Tax Upon Income Derived From the Sale in the United States of Oil Extracted From The Outer Continental Shelf?"

This question is the sole question jurisdictionally placed before the Supreme Court which is related to income. It does not admit of any possibility that the controverted factual issue previously abandoned by Shell at the Trial Court is within its purview, except as a lesser included amount of no separate legal consequence.

To further complicate its own case presentation, Shell, in its Initial Brief

at page 5, stated:

> "To avoid confusion on the important "exclusion" issue, Shell elects not to argue the apportionment issue before the Court."

Apportionment being the procedure by which income is geographically assigned, (albeit also used in special circumstances to determine an income subtraction in a "separate accounting" procedure), Shell once again abandoned its claim that any "sales" occurred on the OCS.

Viewing Ms. Zahner's cited statements, particularly in the light of the history of this litigation and the generic nature of the certified question, the statements she uttered were precisely correct and exquisitely appropriate responses within the frame of reference of the question certified to the Supreme Court.

In view of the Department's analysis

as expressed herein, Shell may wish to consider withdrawal of its criticism of Ms. Zahner's statements, and consider including an appropriate apology for its utterance.

Collaterally, Shell, having access to the hearing transcript, may wish to review its oral utterances before the Court to determine the extent to which it adhered to its election expressed in writing to that Court "not to argue the apportionment issue." An edited transcript in which Shell's oral arguments are stated sans all argument related to apportionment would be brief indeed.

In one sense, Shell is in a situation parallel to that Mobil once created for itself (see Mobil Oil Corp. vs. Commissioners of Taxes of Vermont). The U.S. Supreme Court noted in its decision that Mobil, "In keeping with its

litigation strategy...appellant (elected) to attack the tax base rather than the (apportionment) formula" and thereby "substantially narrow(ed) the issues before us."

The Department questions the propriety of inclusion of the reference to the percentage of sales occurring at the wellhead on the OCS in Shell's Reply Brief to the Supreme Court. The certified question is essentially a restatement of the issue addressed in Shell's Motion for Summary Judgment. That question is related solely to the legal issue, the controverted factual issue of sales actually occurring on the OCS having been constructively abandoned by Shell in the Trial Court. As such, evidence related to existence of "OCS sales" is merely evidence in respect of an irrelevancy and has no proper place in the frame of reference of the question

certified. If Shell's case has been damaged by its abandonment of the potential factual issue reflected in the Trial Court record, the wounds are self-inflicted and the responsibility therefore cannot now be visited upon the Department nor the Assistant Attorney General acting as its trial counsel.

The Department notes that Shell's proffered evidence in respect of the irrelevancy was first resurrected in Shell's Reply Brief to the Court well after the Department's opportunity to make written objections thereto had expired under usual procedures as it had previously filed its last brief. If a cry of "Foul!" is to be voiced, it should emanate from the Department's side of the field and not from that of Shell. Inasmuch as the Department's opportunity to do so has been precluded by Shell's timing, does not Shell bear a continuing

burden to point out to the Court the procedural facts related to its reincarnated issue and reconcile same to the Appellate Court's statement that "...the income... was realized totally from sales of oil in the various states of the United States"?

Lastly, your letter concludes that removal of the income arising from the controverted "OCS sales" would reach a result that "the entire assessment is no longer at issue." Even if such removal were conceded arguendo, based upon the auditor's revised reports the allegation that the result renders the entire assessment a nullity is an invalid conclusion. For example, for the year 1972, the auditor restored the $61,478,714 of gross receipts arising from "sales from OCS" which Shell had subtracted to the denominator of the sales fraction. For that year, the

auditor restored to income the amount of $273,532,841 attributable to "Value of Production (OCS)" as excluded by subtraction by Shell in its return for that year. It is submitted that gross receipts of $61 million cannot give rise to $273 million of net income. Rational deduction would conclude that only a minor percentage (derived from overall profit ratios) of $61 million is properly the income attributable to Shell's own self-declared measure of "OCS sales," where Shell has in fact established such sales. If based upon Shell's self-declared "OCS sales," the net income eligible for subtraction under the Department's position would be in the range of 2 percent of the amount excluded by subtraction in Shell's return for 1972. While varying in degree, the same computational dichotomy exists in each of the years at issue.

Necessarily, the instant assessments are founded upon disallowance of the claimed exclusion by subtraction of greater amounts of income derived from production and not upon any substantially lesser included amounts of what Shell now colors as net income derived from controverted "OCS sales". Thus your conclusion as to the nullity of the entire assessment is unquestionably invalid.

Any act of man may be flawed due to human frailty. When the Department discovers that its findings are in error, all appropriate steps are taken to correct its actions. Note that in the Shell case, the Department did exactly that. Upon recognition of an error in its construction of the property fraction, Shell was granted full relief as to that fraction.

However, as to the sales fraction, the Department remains unconvinced that its findings are in error and the Appellate Court appears to have shared such lack of conviction. The Department requires proof by documentation in the form of representative sales invoices with related shipping documents to fix situs of sales. Shell has presented only one self-serving, albeit sworn, statement of conclusion uttered by an employee, untested under cross-examination and totally devoid of documentation. This presentation the Department deems an unacceptable substitute. Lastly, in the Department's view, Shell's moment during which it was ripe to address correction of the construction of the sales fraction has long since passed. The sole question related to income now before the Court is exclusively one of law related to a claimed pre-emption by operation of a

federal statute.

In conclusion, the Department hereby informs you that it will make no effort to notify the Court in respect of the matters contained in your letter. Its further actions will be in response to such other actions as Shell or others may take or to further action by the Court as the Department deems appropriate. However, the Department would have no objection if Shell were to unilaterally initiate appropriate action to correct its presentations to the Court, including action to honor its written elections and choices previously manifested in the progress of this litigation. Lastly, this response is solely the response of the Department and does not in any sense encompass the action, if any, which the Office of the Attorney General may deem appropriate.

Sincerely,

William D. Townsend
General Counsel

CERTIFIED MAIL
RETURN RECEIPT RQUESTED

WDT/FJS/mm

cc: Mr. Arthur England
Fine, Jacobsen, Schwartz,
Nash, Block and England
2401 Douglas Road
Miami, Florida 33134

Ms. Sharon A. Zahner
Assistant Attorney General
The Capitol
Tallahassee, Florida 32301

Joseph C. Mellichamp III, Esq.
Assistant Attorney General
The Capitol
Tallahassee, Florida 32301

Mr. Sam D. Alexander
Director, Division of Audits
Room 617, Fletcher Building
Tallahassee, Florida 32301

March 20, 1986

Mr. William D. Townsend
General Counsel
Department of Revenue
Tallahassee, Florida 32301

RE: SHELL OIL COMPANY V. DEPARTMENT OF REVENUE
#66,240, #66,254 FLORIDA SUPREME COURT

Dear Mr. Townsend:

Your letter rightly focuses on the cause of our dismay with Ms. Zahner's oral argument which is her apparently inadvertent misstatement of fact--her statement that the State of Florida is not herein attempting to tax the income from sales made at the platform. Shell is concerned with the establishment of a wholly consistent position within the Department--either all sales occurring on the OCS are excluded from the tax base or they are not. The auditor did not exclude income from certain platform sales, though Ms. Zahner maintained he

did -- and now the Department is not supporting Ms. Zahner's statement by its refusal to adjust the audit.

As for your assertion that Shell may have abandoned this argument, that is clearly not the case. Shell clearly stated in its first legal document filed -- the Memorandum of Law in support of the Motion for Summary Judgement in the Circuit Court for Leon County, Florida that its "Production Business Income" included actual sales (p. 8). Both the affidavit of the Department's auditor and of J. L. Kennedy referred to "most" marketing. The state's answer recognized that there were some sales at the platform (i.e., on the OCS) though not "substantial sales" in its Answer, s. 9. Thus there was no disagreement regarding fact at the summary judgment stage. The withdrawal of the apportionment issue at

this stage is totally irrelevant, since we are talking only about the composition of the taxable base.

We are, of course, very much concerned with the effect that the misleading statements may have on the Court. One of Shell's arguments was that there was no difference betwwen (sic) actual sales at the OCS wellhead and imputed sales at the OCS wellhead -- and that the realized income in both cases was OCS income and could not be taxed by Florida -- and that the Department's audit of Shell had indeed treated both sales in like manner by including the realized income from both in the taxable base.

However, we await the Supreme Court decision. If it appears that any part of the decision was influenced by Ms. Zahner's statement we will make a Motion

for Clarification. We are, needless to say, disappointed with the position taken in your letter of February 25, 1986.

Sincerely yours,

Elizabeth C. Burton
Tax Attorney

ECB:las

April 29, 1986

Joseph C. Mellichamp, III,
Assistant Attorney General
and
Sharon A. Zahner,
Assistant Attorney General
Department of Legal Affairs
Tax Department
The Capitol
Tallahassee, Florida 32301

Re: Shell Oil Company v.
Department of Revenue

Dear Joe and Sharon:

In accordance with the concession of your counsel during oral argument, the Florida Supreme Court has now held that sales by Shell Oil to independent third parties on the Outer Continental Shelf are excludable from the Florida corporate income tax base. As you know from the recent exchange of correspondence with Elizabeth Burton of Shell, the assessment against Shell at the present time does not reflect this necessary adjustment.

You are hereby directed to revise the present assessment in accordance with

the Supreme Court's directive, and to advise us of the revised assessment immediately. In the event we do not have your revised assessment while the record remains before the Florida Supreme Court, we shall advise the Court of your refusal to comply with their directive and demonstrate our basis therefor.

Sincerely,

Arthur J. England, Jr.

AJEJr./jt

cc: Elizabeth C. Burton, Esq.

February 11, 1986

CERTIFIED MAIL
RETURN RECEIPT REQUESTED
Division Director, Division of Audits
State of Florida
Department of Revenue
Tallahassee, Florida 32301

Gentlemen:

By this letter we are asking for automatic relief from taxes assessed on Shell Oil Company's ("Shell") income derived from sales occurring on the Outer Continental Shelf ("OCS").

Shell Oil Company v. Department of Revenue, # 66,240, # 66,254 was argued before the Supreme Court of Florida on January 7, 1986. Shell claimed that income derived from sales of OCS oil and gas could not be subject to Florida's income tax due to the mandate in the Outer Continental Shelf Lands Act which states that "state taxation laws shall not be applied to the Outer Continental

Shelf." 43 U.S.C. s. 1333(a)(2)(a).

For the years in controversy, (1972-1975) Shell had certain sales of OCS oil and gas production occurring at the wellhead on the OCS. The percentage of sales occurring at the wellhead were enumerated in Defendant's Initial Interrogatories to Plaintiff, No. 29(c) and were incorporated on page 8 in Shell's Reply Brief filed with the Supreme Court of Florida.

Shell did not include the net income from any of its OCS production in the Florida adjusted Federal tax base. The Department's auditor did add-back the net income from all of Shell's OCS production including these sales at the wellhead in determining the Department's assessment. On oral argument, Ms. Zahner, the Department's attorney, stated, "There may

have been some sales out there. There may have been. But there are no sales in this assessment that were out there." (TR-15) The Court continues to pursue this statement, asking how "the ones sold at the wellhead" would appear, would they be taken out. To which Ms. Zahner replies, "They would have to be taken out." And in reply to the Court's question "And you do take those out?" Ms. Zahner says, "Yes." (TR-16)

Ms. Zahner's statements are not representative of the treatment accorded Shell in this case. If the Department's position is to remove the income from the sales on the OCS from the tax base then we request it do so, adjust our assessment, and advise the court that the entire assessment is no longer at issue. If the Department's position is to not remove such income, as reflected in its

1972 - 1975 audit assessment, then we request that the Department file a notice with the Court that the Department's position was misrepresented by Ms. Zahner in oral argument and specifically correct her misstatements which are more numerous than those specifically set out above.

We request that the Department make appropriate notification to the Court within fifteen days of receipt of this letter, and that Shell be advised respecting the Department's action. If we have not been so advised within fifteen days we will take appropriate action.

Sincerely yours,

Elizabeth C. Burton
Tax Attorney

ECB:oa

cc: Mr. Arthur England
Fine Jacobsen Schwartz Nash
Block and England
2401 Douglas Road
Miami, FL 33134

Ms. Sharon Zahner
Assistant General Counsel
Department of Revenue
Carlton Building
Tallahassee, FL 32301

Joseph C. Mellichamp III, Esq.
Assistant Attorney General
The Capitol
Tallahassee, FL 32301

Appendix 15

IN THE SUPREME COURT OF THE STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. CASE NO. 66,240 & 66,254

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Respondent. /

MOTION TO STRIKE AND EXPUNGE RECORD

The Respondent, the Department of Revenue, by and through its undersigned attorney and pursuant to Fla.R.App.P. 9.300, respectfully requests that this Court strike the Petitioner's Motion for Order Compelling Compliance with Court Decision and expunge the record of the documents attached thereto. As grounds therefore the Respondent states as follows:

1. The Petitioner has filed a Motion for Order Compelling Compliance with Court Decision. However, the Peti-

tioner has also filed a Motion for Rehearing. Fla.R.App.R. 9.300 makes clear that an Order upon which a Motion for Rehearing is pending, is not final. Therefore, the Petitioner has asked for enforcement based on a non-final order. This Motion for Order Compelling Compliance with Court Decision is wholly inconsistent with the Petitioner's Motion for Rehearing and should therefore be stricken.

2. The Motion for Order Compelling Compliance with Court Decision seeks to absolutely disregard that portion of the decision of this Court which embraces the facts upon which the decision is founded. If Shell believes that this Court has mistaken the facts, then it should so argue in a Motion for Rehearing. Not anywhere in its Motion for Rehearing does Shell complain that this Court has made a mistake as to the facts in this case.

Rather the First District Court of Appeal and this Court have stated, based on the finding of fact in the trial court, that the income in the Petitioner's case was realized totally from sales of oil in the various states of the United States. Shell Oil Co. v. Department of Revenue, 461 So.2d 959, 961 (Fla. 1st DCA 1984) and Shell Oil Co. v. Department of Revenue, Nos. 66,240 and 66,254, at 2 (Fla., April 24, 1986). The Petitioner's Motion for Order Compelling Compliance with Court Decision is an attempt to relitigate facts determined by the trial court and restated in the opinion of the First District Court of Appeal and in this Court's decision. As this Court stated in its decision, "Shell contends that the time and location of the actual sales are irrelevant..." Shell Oil Co. v. Department of Revenue, Nos. 66,240 and 66,254, at 2 (Fla., April 24, 1986).

Petitioner's Motion for Order Compelling Compliance with Court Decision, made post decision, now attempts to reverse its position and make relevant that which was irrelevant at all states of the instant appeal process. Accordingly the Petitioner' Motion for Order Compelling Compliance with Court Decision is an attempt to move this Court to force the Respondent to act in a manner counter to the facts as determined in this case and the position the Petitioner has heretofore taken.

3. Incredibly, the Petitioner has included a document with its Motion for Order Compelling Compliance with Court Decision which should be the basis for rejecting the Motion. The Motion for Order Compelling Compliance with Court Decision introduced an extract from an administrative hearing in Iowa. This extract indicates that Shell has

stipulated for the years at issue in the Iowa controversy that it made no sales on the Outer Continental Shelf. Because there is an overlap of the years in controversy in the Iowa case and the case sub judice, this documents serves as a self executing impeachment of the answer of Interrogatory of number 29 of the Respondent's Initial Interrogatories which is the basis of the Petitioner's Motion for Order Compelling Compliance with the Court Decision.

4. The Respondent asserts that the Motion for Order Compelling Compliance with Court Decision is a disingenuous attempt to introduce facts into the record which could not be introduced in a Rule 9.330 Motion for Rehearing. As noted above, the facts of this case establish that there were no actual sales on the Outer Continental

Shelf which were included in the assessment.

Among the documents submitted with the Petitioner's Motion for Order Compelling Compliance with Court Decision is a letter written by Petitioner's out-of-state counsel of record to one of Respondent's operating division heads. It was not written to Respondent's General Counsel or either of its attorneys of record. In that letter, Petitioner's out-of-state counsel of record alleged, "that the Department's position was misrepresented by Ms. Zahner." This allegation is specious and unfounded.

On February 25, 1986, Petitioner's General Counsel responded to that letter (a copy of which was submitted with Petitioner's Motion for Order Compelling Compliance) and explained to all parties that the allegation was unfounded,

baseless, contained flawed conclusions and was, therefore, totally improper.

Now, in pressing its Motion for Order Compelling Compliance with Court Decision, Petitioner's instate counsel of record has re-stated the original unfounded allegation contained in the original letter. This "ad hominem" attack on an Assistant Attorney General's personal and professional integrity is without merit and contrary to the established facts in the record before the Court.

Respondent's objection respectfully submitted warrants striking the proffered Motion for Order Compelling Compliance with Court Decision. Further, all letters referred to above should be expunged from the Court's files. Granting this Motion to Strike and Expunge Record will prevent futher public review of this matter and limit any

potential damage which inherently arises from re-publication of these unwarranted and unjustified allegations.

5. It appears that the purpose of the Petitioner's Motion for Order Compelling Compliance with the Court Decision is to avoid the restrictions of Fla.R.App.P. 9.330, under which the Petitioner moved for rehearing. No separate legal issues are raised by the Motion to Compel Compliance. Likewise there is no apparent justification for moving separately for such order. Thus, it appears that the purpose of the separate Motion for Order Compelling Compliance with Court Decision is an attempt to use Fla.R.App.R. 9.300 to bring non-record documents before the Court. As stated in the Response to the Motion for Rehearing, the Petitioner's Motion for Order Compelling Compliance with Court Decision appears to be an unauthorized

extention of the Motion for Rehearing. Therefore, the Motion for Order Compelling Compliance with Court Decision should be stricken and the record expunged of the documents attached thereto.

WHEREFORE, the Respondent prays that this Court strike the Motion for Order Compelling Compliance with Court Decision and expunge the record of the documents attached to said Motion because the Motion is unauthorized, redundant, immaterial, impertinent and scandalous. Attorneys fees and the costs in responding to Petitioner's Motion for Order Compelling Compliance with Court Decision should be granted to Respondent.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

JOSEPH C. MELLICHAMP, III
SHARON A ZAHNER
Ass't Attorneys General
Dept. of Legal Affairs
Tax Section, Capitol
Building
Tallahassee, FL 32301
904/487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to WILLIAM D. PELTZ, Senior Tax Counsel & ELIZABETH C. BURTON, Tax Attorney, Shell Oil Co., P. O. Box 2463, Houston, TX 77001 and ARTHUR J. ENGLAND, JR., Esq., 2401 Douglas Road, Miami, FL 33134, this 17th day of June 1986.

JOSEPH C. MELLICHAMP
Ass't Attorney General

15-10

Appendix 16

IN THE SUPREME COURT OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240
66,254

DEPARTMENT OF REVENUE,

Respondent. /

Response to Motion to Strike and Expunge

Shell Oil Company files this response to the Motion to Strike and Expunge filed by the Department of Revenue. The Department has asked the Court to strike Shell's motion of May 19. In that motion, Shell merely requested that the Court order the Department to direct compliance with an unchallenged portion of the Court's decision regarding the computation of Shell's tax liability, if any is ultimately held to be due. The Department's motion should be denied.

1. First and foremost, the Department's motion should be denied because it does not dispute the underlying fact on which Shell's motion rests -- to wit, that the Department has computed Shell's potential income tax liability inaccurately, and inconsistently with this Court's April 24 decision.

The issue at stake here is the exclusion from Shell's income of revenues derived from actual sales of oil and gas on the Outer Continental Shelf. Based on the representation of counsel for the Department, the Court held that such sales are excludable from Shell's taxable income. See 11 F.L.W. at 185.

Shell's motion request only that the Court direct the Department to comply with its representations and the Court's decision. In paragraphs 3 and 4 of the motion, Shell asserts that there were actual sales on the OCS in the years in

question, and that the Department did not exclude them from Shell's taxable income. The Department's rather heated motion to strike does not controvert those assertions. It argues vehemently about various things, all of which are addressed below, but it does not suggest that Shell is wrong in saying that the Department has in fact taxed income from OCS sales.

Shell reasserts that the record in this case in fact demonstrates that the Department's proposed tax assessment included amounts to which the Department is not entitled. Under these circumstances, the Court should deny the Department's request to strike Shell's motion, and the Court should direct the Department to comply with the Court's decision as regards actual sales on the OCS.

2. Shell responds to each of the

numbered paragraphs in the Department's motion as follows.

(a) paragraph 1. The Department states that, because a rehearing has been requested, Shell's motion asks for enforcement of a non-final order and, therefore, should be stricken. The Department is technically correct as to the non-finality of the Court's action. That does not suggest that Shell's motion should be stricken, however. Rather, it suggests that the motion should await the Court's rehearing determination. Shell would concede that its motion will become moot if the Court reconsiders and holds for Shell on the OCS issue. But Shell would have been negligent not to raise the miscomputation of its tax liability, under the Court's decision as announced on April 24, as soon as the matter could have been raised. The earliest opportunity, of course, was when the Court

ruled against Shell on the OCS issue in its April 24 decision.

(b) paragraph 2. The Department next contends that Shell is endeavoring to reargue or relitigate the facts of the case. Nothing could be further from the truth. The facts in the case are those established in the record.[1] Shell knows that those record facts reveal a tax levy roughly 20% in excess of that which the Department concedes, and the Court has held is legally due. Shell is content to rely on the record on this issue. Indeed, Shell has identified the record basis for these facts in its reply

[1] The Department refers the Court to the decision of the district court for the facts. That court's decision is not a substitute for the record as to facts, and in any event nothing in that court's decision says that all OCS revenues were non-sale transfers. Even if the Department believes all revenues were of that type, however, it has led this Court into error, for the Court has stated the contrary based on counsel's representations.

brief. Nowhere in the record, or in its briefs, has the Department contested or controverted these record facts.[2]

(c) paragraph 3. The Department relies on an unsworn, non-record piece of paper, allegedly "an extract from an administrative hearing in Iowa," to prove that Shell made no actual sales on the OCS. This suggestion is truly astonishing. This "extract" was sent by mail to Shell from counsel for the Department following Shell's administrative request to resolve the computation problem. Apparently, the extract was sent to demonstrate that Shell was indeed taxed properly in Florida. The Department's transmittal letter

---

[2] The computation dispute is easily resolved by reference to the record. As an alternative, Shell has suggested in its motion that the Court could appoint and permit a special master to examine the record and report to the Court whether the Department has in fact overcharged Shell.

represents that the extract is a page from a brief filed by the Iowa Department of Revenue in an administrative proceeding there. It obviously demonstrates nothing at all relevant to Shell's Florida tax liability.

(d) paragraph 4. Lastly, the Department views an exchange of correspondence which is attached to Shell's motion as a personal attack on counsel for the Department. This concern is wholly unfounded, and regrettable. This correspondence was attached to Shell's motion to demonstrate that Shell had endeavored to resolve the tax computation dispute administratively (which is why Shell's letter was sent to the Department rather than to its attorneys), without involving the Court. The reaction of counsel for the Department to Shell's administrative request, both initially in its letter to Shell and now in its motion

to strike, in unexplainably extreme.

Shell did not intend to and has not impugned the Department's counsel. Shell wrote an operating division of the Department because, as Shell's letter stated, Ms. Zahner's several statements to the Court were "not representative of the treatment accorded Shell in this case" by the Department. Her statements were what they were, and the record is what it is. The two are not consistent. Because the Department has refused to reconcile the inconsistency, Shell was obliged to seek relief from the Court.

Ms. Zahner's integrity is not at issue. Her client, the Department, has put her in an untenable position. Either the Deparmtent had a continuing obligation to conform the actual tax treatment accorded Shell to Ms. Zahner's statements to the Court, or it had an obligation to advise Ms. Zahner that these

statements to the Court were incorrect and allow her to correct them. It has choosen to do neither.

(e) paragraph 5. The Department suggests that Shell's motion ws merely a pretext to circumvent the restrictions of Rule 9.330. That argument is nonsense. Shell does not and did not want this issue reheard. The Court ruled correctly in favor of Shell on the exclusion of actual sales on the OCS. No rehearing is needed.

3. The Department has asked the Court to expunge Shell's motion and attachments. The Department offers no legal basis, statutory or otherwise, to expunge the records in the Court. None exists.

The Department's motion to strike and expunge should be denied. As the Department has not presented the Court with any response to the assertions in Shell's

motion, it should be granted. The Department should be compelled, if Shell ultimately does not prevail on the OCS issue, to comply with the Court's directive. Shell again suggests, however, that if there lingers any doubt as to the Department's mis-computation of OCS tax liability, then the Court should appoint a special master to resolve the factual disagreement between the parties, based on the record in this case, and to report its findings to the Court.

Respectfully submitted,

William D. Peltz,
General Tax Attorney,
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
Post Office Box 2463
Houston, Texas 77001
(713)241-2414

Arthur J. England, Jr.,
Esq.
Fine Jacobson Schwartz
Nash Block & England,
P.A.
2401 Douglas Road
Miami, Florida 33134
(305)446-2200
Attorneys for Petitioner

Certificate of Service

I certify that true and correct copies of this motion were mailed on June 25, 1986 to Joseph C. Mellichamp, III., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

By: _____

AJEJr./jt

04382.001

Supreme Court, U.S.
FILED
MAY 20 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1593

In The Supreme Court Of The United States

October Term, 1986

Shell Oil Company,

Appellant

vs.

Department of Revenue,
State of Florida,

Appellee

Appeal

from the Supreme Court of Florida

Appellant's Reply Brief

J. Lloyd Kennedy
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 77252
(713) 241-3386

Of Counsel

Arthur J. England, Jr.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

Attorney for Appellant

Table of Contents

	Page
Table of Authorities.....	ii
Reply.....	1

Table of Authorities

Cases	Page
Maryland v. Louisiana, 451 U.S. 725 (1981).....	7
Shell Oil Company v. Department of Revenue, 496 So.2d 789 (Fla. 1986).....	8

Statutes

43 U.S.C. § 1333(a)(2) and (3) (1972).....	passim

Reply

This Reply is written to focus the issue posed by Shell's Jurisdictional Statement and the Department of Revenue's motion to dismiss or affirm.

The Department has devoted an unusually large amount of its motion to matters which have not been raised by Shell and are not in controversy in this proceeding. Over one-half of the Department's motion is used to discuss income apportionment, whether Florida has properly applied federal income tax concepts against Shell, and if some of Shell's sales of oil and gas were consummated on the outer Continental Shelf ("OCS"). The Court should not be deceived or confused by these irrelevancies.

One issue alone is presented for the Court's review. That issue is whether the unambiguous declaration of Congress that "state taxation laws shall not apply to the

outer Continental Shelf"[1] is to be given any effect whatsoever. Six, short questions will frame that issue.

The answers to these six questions will demonstrate that Florida has ignored the eleven word proscription of Congress, has thwarted Congress' intended effect, and has in fact imposed its state taxation law "to the outer Continental Shelf."

1. Does Shell perform activities of an economic nature on the OCS? Of course it does, and the Department does not say otherwise.

2. Does the federal government derive an economic benefit from Shell's activities? Yes, it derives a direct economic benefit

---

1 43 U.S.C. §1333(a)(2)(1972). See Appendix 9 to Shell's Jurisdictional Statement.

in the form of lease OCS royalties. The Department does not suggest otherwise.

3. Are those benefits to the federal government adversely affected by what Florida has done through its state income tax law? Of course they are, and the Department does not suggest otherwise.

4. Did Congress intend by section 1333(a)(2) to prevent state tax laws from creating adverse economic effects on federal revenues from OCS properties? Of course it did.

Ordinary statutory construction rules apply here. By applying those rules, it is plain as day that Shell's taxation by Florida is preempted by the OCS Act. The intention of a statute is primarily determined by examining the words chosen by Congress. Congress wrote: "State taxation laws shall not apply to the outer Continental Shelf." Those words are

unambiguous. Congress spoke as plainly as words can possibly be framed.

The legislative history of this eleven word formulation, moreover, is consistent with its evident meaning. Congress intended to bar all forms of state taxation, both direct and indirect. See Shell's Jurisdictional Statement at pages 15-17. The Department does not argue for a different statutory meaning or intent. It simply assumes the unstated position that an income tax levy on Shell is neither a direct or an indirect tax affecting OCS because Congress meant to ban only severance-type taxes. By this means, the Department simply ignores the very real economic impact which occurs through a reduction of lease revenues due to state tax burdens placed on OCS lease bidders.

That is, by hiding behind the federal income tax concept of "realization" to

suggest that OCS production income is a phantom or non-existent type of economic revenue, the Department and the Supreme Court of Florida mask the taxation of OCS production income by subsuming it into subsequent sales which in fact encapsulate that income. This approach ignores the entire history of the federal ban on state taxation of outer Continental Shelf properties. (See Shell's Jurisdictional Statement at pp. 14-19 and Appendix 1 at pp. 1-21 through 1-27).

Nor does the Department's and the Florida Supreme Court's superficial treatment of this issue, using realization to block analysis, address the preemptive rationale of the federal ban. The federal statute reflects a resolution of twenty seven years of debate as to whether state tax laws of any type, whether directly or indirectly imposed, should be allowed to impact federal lease revenues. In responding to

Shell's Jurisdictional Statement, the Department blithely ignores this rationale for the eleven word prohibition. (See Shell's Jurisdictional Statement at pp. 15-16, 19-21).

Shell submits that the words "state taxation laws shall not apply to the outer Continental Shelf" have a meaning that is not difficult to construe. It is easy to demonstrate that the Florida Supreme Court has held the state's income tax laws in fact do "apply" to the OCS. Shell excluded from its taxable income reported to Florida all production income derived from OCS properties, computed in accordance with the same methodology used for computing lease revenues to the federal government and for other relevant, federal income tax computations. The Department added the production income back into Shell's income for Florida tax purposes. The Florida Supreme Court upheld the inclusion of that

income. It could not be more plain that Florida taxation laws are being made to "apply" to the Shelf in each year that Shell's income is taxed in Florida.

The prohibition against the application of state tax laws to the OCS must mean that OCS income is to be disregarded in computing state taxes, or the OCS Act will mean nothing. In Maryland v. Louisiana, 451 U.S. 725 (1981), the Court implied that it would require Shell's OCS income to be disregarded by Florida in computing its income tax. The Court clearly indicated in that case that it would consider the application of state income tax laws to OCS income to be in violation of the OCS Act. The only reasonable way for Florida to conform to the OCS Act is to exclude OCS production income in computing Shell's state income tax burdens.

5. Did Shell raise and preserve the issue of federal preemption in this

proceeding? It is undisputed that Shell raised sections 1333(a)(2) and (3) of the Outer Continental Shelf Lands Act as a bar to the taxation of Shell's OCS production income in its Florida tax returns, at every phase of administrative and court proceedings in this case, and before the Florida Supreme Court.

6. Did the Supreme Court of Florida pass on the issue squarely? Yes. The Florida Supreme Court ruled squarely on the issue which Shell has asked the Court to review:

> . . . Shell contends that the time and location of the actual sale are irrelevant because no sale of OCS production can ever be subject to state taxation. Shell claims that section 1333(a)(3) of the outer Continental Shelf Lands Act supports this contention . . . . We find that Shell's reliance on section 1333(a)(3) is misplaced.

Shell Oil Company v. Department of Revenue, 496 So.2d 789, 790 (Fla. 1986), reproduced in Appendix 1 to Shell's Jurisdictional

Statement on page 1-9.) See also the dissenting opinion of Chief Justice Boyd in that case, in which Justice Shaw concurred, which asserts in detailed analysis why the OCS Act prohibits Florida from taxing OCS production income. (Appendix 1 at pp. 1-18 through 1-36).

Six simple, affirmative answers to the six, key questions prove that the issue posed by Shell in this proceeding is ripe for the Court's review. Other points raised by Shell, which are neither addressed nor controverted by the Department, demonstrate why the Court should accept review.

Shell has described this Court's continuing solicitude for congressional intent with respect to the outer Continental Shelf. (Shell's Jurisdictional Statement at pp. 17-19). Shell has described the expanding endeavors of the various states to impose their own

apportioned state income taxes on production income and thereby erode federal revenues from OCS leases. (Shell's Jurisdictional Statement at pp. 21-23). The Department's silence on these matters speaks loudly of its hope that the Court will ignore states' efforts to thwart congressional will as expressed in the eleven words of section 1333(a)(2).

The Court should not permit this to occur. The Court should accept this case for plenary review and reject the Department's request to have this appeal dismissed or affirmed.

Respectfully submitted,

Arthur J. England, Jr.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

J. Lloyd Kennedy
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 77252
(713) 241-3386

(A7)

No. 86-1593

Supreme Court, U.S.
FILED
OCT 16 1987
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

DEPARTMENT OF REVENUE, STATE OF FLORIDA

ON APPEAL FROM THE SUPREME COURT OF FLORIDA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

CHARLES FRIED
Solicitor General

MICHAEL C. DURNEY
Acting Assistant Attorney General

ALBERT G. LAUBER, JR.
Deputy Solicitor General

RICHARD J. LAZARUS
Assistant to the Solicitor General

RICHARD FARBER
STEVEN W. PARKS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

24pp

QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act, 43 U.S.C. 1333(a)(2)(A), which provides that "State taxation laws shall not apply to the outer Continental Shelf," limits a State's authority to tax an apportioned fraction of income earned from the sale within the United States of oil extracted from the Outer Continental Shelf.

TABLE OF CONTENTS

	Page
Statement	1
Discussion	5
Conclusion	18

TABLE OF AUTHORITIES

Cases:

Commissioner v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974)	16
Container Corp. of America v. *Franchise Tax Bd.*, 463 U.S. 159 (1983)	5, 16
Eisner v. *Macomber*, 252 U.S. 189 (1920)	10
Exxon Corp. v. *Dep't of Revenue*, 447 U.S. 207 (1980)	5-6
Gulf Offshore Co. v. *Mobil Oil Corp.*, 453 U.S. 473 (1981)	8, 11, 12, 15
Japan Line, Ltd. v. *County of Los Angeles*, 441 U.S. 434 (1979)	7
McCarty v. *McCarty*, 453 U.S. 210 (1981)	7
Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425 (1980)	6
Rodrigue v. *Aetna Casualty Co.*, 395 U.S. 352 (1969)	8, 12
Rose v. *Rose*, No. 85-1206 (May 18, 1987)	7
Schwegmann Bros. v. *Calvert Distillers Corp.*, 341 U.S. 384 (1951)	15
Underwood Typewriter Co. v. *Chamberlain*, 254 U.S. 113 (1920)	6
United States v. *California*, 332 U.S. 19 (1947)	11
United States v. *Louisiana*, 339 U.S. 699 (1950)	11
United States v. *Texas*, 339 U.S. 707 (1950)	11

Constitution and statutes:

U.S. Const.:	
Art. I, § 8, Cl. 3 (Commerce Clause)	5, 6, 16
Art. VI, Cl. 2 (Supremacy Clause)	3, 5, 7
Amend. V (Due Process Clause)	5, 6, 16
Internal Revenue Code (26 U.S.C.):	
§ 613	10
§ 613A	10
§§ 4987 *et seq.*	10

—Continued: Page

eral Lands Leasing Act of 1920, § 32, 30 U.S.C. 89 13

er Continental Shelf Lands Act, 43 U.S.C. 1331 *et* :

43 U.S.C. 1333 8
43 U.S.C. 1333(a)(1) 8
43 U.S.C. 1333(a)(2) 4
43 U.S.C. 1333(a)(2)(A) 3, 7, 8, 9, 10, 15, 16
43 U.S.C. 1333(a)(3) 13, 17
43 U.S.C. 1335(a)(9) 9
J.S.C. 1257(2) 6

Stat. Ann. (West Supp. 1987):

§ 214.71 2
§ 220.02 2
§ 220.11 2
§ 220.12(1) 2
§ 220.13(1)(b)(2) 2
§ 220.13(2) 2
§ 220.15(3) 2

neous:

istopher, *The Outer Continental Shelf Lands Act: Key a New Frontier,* 6 Stan. L. Rev. 23 (1953) 11, 12
Cong. Rec. 9206 (1951) 11
Cong. Rec. (1953):

p. 2505 14
p. 2506 14
pp. 2509-2510 13
pp. 2511-2512 11
p. 2523 14
p. 2524 14
p. 2535 13
p. 2571 ..... 11, 15
pp. 2571-2572 14
p. 2575 11
pp. 6963-6964 13
p. 6966 9
p. 7228 ..... 13, 14
p. 7230 14

cellaneous—Continued: Page

p. 7254 14-15
p. 7261 15
p. 7265 12
p. 10419 13
pp. 10471-10472 13

H.R. 4484, 82d Cong., 1st Sess. (1951) 11

H.R. 4198, 83d Cong., 1st Sess. (1953) 11

H.R. Conf. Rep. 1031, 83d Cong., 1st Sess. (1953) 13

H.R. Rep. 695, 82d Cong., 1st Sess. (1951) 11

H.R. Rep. 215, 83d Cong., 1st Sess. (1953) 11

Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs, 83d Cong., 1st Sess. (1953) 14, 15

R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* (6th ed. 1986) 7

S. 1901, 83d Cong., 1st Sess. (1953) 11,12,15

S. Rep. 411, 83d Cong., 1st Sess. (1953) 9, 12, 13, 15

the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1593

SHELL OIL COMPANY, APPELLANT

v.

DEPARTMENT OF REVENUE, STATE OF FLORIDA

ON APPEAL FROM THE SUPREME COURT OF FLORIDA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

---

his brief is submitted in response to the Court's order ting the Solicitor General to express the views of the ted States.

STATEMENT

. Appellant Shell Oil Company is a Delaware cor- ation engaged in exploration for oil and natural gas, as l as production, refining, and marketing of oil and gas ducts. Shell conducts its production activities within ous States and on the Outer Continental Shelf (OCS), re Shell operates a number of drilling platforms for exploration and production of crude oil and natural (J.S. App. 1-6). Shell makes all transfers of OCS ural gas by sale to independent third parties in transac- s completed on the OCS itself (*ibid.*). In the case of de oil, Shell makes some transfers by sale to independ- third parties on the OCS, but delivers most of its OCS to its own pipeline for transport to shore. The oil is n distributed to Shell refineries or chemical plants ted in various States (J.S. App. 1-6 to 1-7; MDA App.

2 to 4-3).[1] Shell markets petroleum products
out the United States, and its primary business ac-
Florida consists of such marketing activities (J.S.
7; MDA App. 2-2).

la imposes a corporate tax measured by "net in-
for the "privilege of conducting business" in
See Fla. Stat. Ann. §§ 220.11, 220.02 (West
987). Under Florida law, a corporation's "net in-
s "that share of its adjusted federal income * * *
apportioned to this state" (*id.* § 220.12(1)). A cor-
's "adjusted federal income" is its taxable income
ral income tax purposes (see *id.* § 220.13(2); MDA
5), as adjusted by, inter alia, subtracting those
"derived from sales outside the United States" net
ses "which are attributable, directly or indirectly
amounts (Fla. Stat. Ann. § 220.13(1)(b)(2) (West
987); MDA App. 1-4 to 1-5). This "adjusted
ncome" is then apportioned between Florida and
ates pursuant to a three-factor formula that takes
count the ratio of the corporation's property,
and sales within Florida to its property, payroll,
s "everywhere" within the United States (Fla. Stat.
214.71, 220.15(3) (West Supp. 1987)).[2]

mputing its Florida income tax for 1972 through
ell excluded from its "adjusted federal income"
to apportionment its actual or deemed earnings
CS oil and gas production. Where Shell consum-
les of OCS oil and gas by transfers to third parties
OCS, the excluded earnings consisted of its gross
from those sales, less related costs and expenses.

A App." refers to the Appendix to Appellee's Motion to
r Affirm.

g the relevant time period (1972 through 1975),
re" meant "in all states of the United States, the District of
, or any political subdivision of the foregoing" (see J.S.
).

re the oil was simply transferred into Shell's own
ine, the amount excluded consisted of the wellhead
market value of the oil, less related costs and expenses
App. 1-6 to 1-7). On audit, appellee Florida Depart-
of Revenue disallowed the claimed exclusion in part,
g that the wellhead value of the OCS oil, less related
nses, had to be restored to Shell's apportionable in-
e (*id.* at 1-7). The Department's action was based on
osition that insofar as Shell's oil was transferred into
wn pipeline rather than sold to third parties on the
, any income ultimately realized from sale of the
ucts into which the oil was refined was realized within
ontinental United States, and hence was includable in
's apportionable income for Florida tax purposes.

Shell brought this action in the Circuit Court for
County, contending that the Supremacy Clause re-
d Florida to exclude the wellhead value of Shell's
oil, less related costs and expenses, from Shell's ap-
onable tax base (MDA App. 2-5 to 2-6). In so
ending, Shell relied on the Outer Continental Shelf
ls Act (OCSLA), 43 U.S.C. 1333(a)(2)(A), which pro-
that "State taxation laws shall not apply to the outer
inental Shelf." The circuit court denied Shell's motion
ummary judgment and granted the Department's mo-
(J.S. App. 3-1 to 3-5).

e district court of appeal affirmed, holding that
LA does not prohibit Florida from taxing income
the sale in the United States of products of oil ex-
ed from the OCS. The court noted (J.S. App. 2-9 to
that, if Shell's position were taken to its logical con-
on, "a state could not impose any tax * * * for any
uct [Shell] derives from its outer continental shelf
," a result that the court believed Congress could not
intended.

3. Upon certification from the district court of appeal (J.S. App. 2-24), the Florida Supreme Court affirmed the holding that OCSLA does not prohibit a State from imposing a tax upon income derived from a sale in the United States of products of oil extracted from the OCS. The court emphasized (*id.* at 1-8) the Department's concession that "any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by Section 1333(a)(2)," and hence that "the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states." The court reasoned that because the sales of oil occurred in the United States, and because "both parties agree[d] that Florida can generally levy an apportioned tax on income derived within any of the fifty states" (J.S. App. 1-12), the tax in question did not infringe upon the federal government's exclusive jurisdiction over the OCS. As the court viewed the matter, a state tax on income derived from those sales was not preempted by OCSLA because Section 1333(a)(2) "simply constitutes a limitation of state authority over the OCS area and does not seem intended to address income derived outside the OCS" (J.S. App. 1-9 to 1-10 (footnote omitted)).

Two justices dissented (J.S. App. 1-18 to 1-36). They concluded that Florida's corporate income tax as applied "directly conflicts" with the federal prohibition against the application of state tax laws to the OCS. They further asserted (*id.* at 1-26) that Florida's tax is at odds with "the major purpose" of OCSLA, which is "to give the federal government exclusive control over the development and production of the mineral resources lying outside the three mile limit."[3]

---

[3] The Florida courts also addressed various issues relating to the proper calculation of Florida's apportionment formula. Although

DISCUSSION

Appellant contends that the Outer Continental Shelf Lands Act limits state authority to tax income earned from the sale in any State of products derived from oil produced on the OCS. Shell concedes that the States may tax such income insofar as it is deemed to derive from downstream refining and marketing activities carried on within the fifty States. Shell contends, however, that the States must "back out" from Shell's apportionable tax base that portion of its income deemed to derive from exploration and production activities occurring on the OCS, even though that income is not realized within the OCS through third-party sales. This "backing out" is to be accomplished, in Shell's view, by reducing its apportionable income by the wellhead fair market value of its OCS crude, less related costs and expenses.[4] This supposed federal statutory limitation is based on the Supremacy Clause and is wholly apart from any constitutional limitations imposed by the Due Process and Commerce Clauses on a State's apportionment, for income tax purposes, of income derived from a company's activities in multiple jurisdictions. See, *e.g.*, *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Exxon Corp.* v. *Dep't of Revenue,*

Shell asserts (J.S. 21) that the States have engaged in "manipulation of apportionment factors and formulae" and that there is "no uniformity" among the States in the methodologies used, Shell has not actually presented any such Due Process or Commerce Clause questions to this Court (see J.S. i; Reply Br. 1-2). We accordingly do not address them.

[4] Shell refers (see, *e.g.*, J.S. i, 19, 22; Reply Br. 10) to the wellhead value of its OCS oil, less related costs and expenses, as "production income." The mere act of extracting oil, however, does not give rise to income under federal or state income tax laws. See pages 9-10, *infra*. The term "production income," as used by Shell, is thus an economic or accounting concept that has no particular legal significance.

447 U.S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes,* 445 U.S. 425 (1980); *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113 (1920). For purposes of this appeal, therefore, we may assume that Florida's apportionment of Shell's income comports with generally applicable Due Process and Commerce Clause requirements. Indeed, Shell in this Court specifically disclaims any challenge to Florida's apportionment formula. See note 3, *supra.*

In our view, the Florida Supreme Court—the first state supreme court to address the issue—correctly rejected Shell's preemption claim. The statutory language, the structure of the statute, and the relevant legislative history show that Congress intended in OCSLA to bar any State from subjecting activities on the OCS to taxation as if the OCS were located within the State's borders. A State, therefore, may not impose a severance, production, property, or sales tax on Shell's activities on the OCS. Nor, as Florida has properly conceded (see J.S. App. 1-8), may a State, consistently with the Supremacy Clause, tax income earned by Shell from OCS oil or gas sales that are completed on the OCS itself. The legislative record, however, provides little support for Shell's more sweeping notion that Congress intended in OCSLA to limit state taxation of income earned from sales of products of OCS oil completed outside the OCS and within state borders.

Because we believe the decision of the Florida Supreme Court to be correct, and because the case involves a question of first impression that is of no great importance to the United States, we would have little hesitation in urging that review be denied if the case were here on writ of certiorari. The case, however, is an appeal.[5] Although we

[5] Although appellant as a protective matter has alternatively invoked this Court's certiorari jurisdiction (see J.S. 2-3), we believe that the case is clearly an appeal. Section 1257(2) of 28 U.S.C. provides that an appeal lies from the decision of a state court "where is drawn

find appellant's preemption argument unpersuasive, we do not regard it as being so weak as to render the federal question altogether "insubstantial." Accordingly, we cannot escape the conclusion that probable jurisdiction should be noted.

1. Shell's preemption claim turns on the meaning of 43 U.S.C. 1333(a)(2)(A), which provides that "State taxation laws shall not apply to the outer Continental Shelf." According to Shell (J.S. 15; Reply Br. 3), this provision manifests congressional intent to preempt "any form of state levy, direct or indirect, [that] would adversely affect the amounts of revenue available to the federal government from the sale of leases for exploration and production of Shelf lands." We do not agree that the statute's preemptive force extends so far.[6]

---

in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity." This Court has "held consistently that a state statute is sustained within the meaning of § 1257(2) when a state court holds it applicable to a particular set of facts as against the contention that such application is invalid on federal grounds." *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 441 (1979). Accord, *e.g.*, *Rose* v. *Rose*, No. 85-1206 (May 18, 1987), slip op. 4 n.3; *McCarty* v. *McCarty*, 453 U.S. 210, 219-220 n.12 (1981); R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 112-113 (6th ed. 1986). Appellant in the instant case squarely argued that Florida's income tax could not, consistently with the Supremacy Clause, be applied to products of OCS-derived oil because OCSLA prohibits such taxation. The Florida Supreme Court rejected that argument, sustaining the Florida tax as thus applied. Accordingly, this is an appeal.

[6] Shell's preemption argument does not extend simply to state income taxes levied by States adjacent to the OCS. Rather, Shell's argument would require every State to exclude the wellhead value of Shell's OCS oil, less related expenses, from the company's apportionable tax base. Shell accordingly has brought a lawsuit similar to this one against the State of Iowa, which is currently pending before the Iowa Supreme Court. See J.S. 22 (citing *Shell Oil Co.* v. *Iowa Dep't of Revenue*, No. 86-1565 (Iowa)). A lawsuit brought by another oil com-

The more limited purpose of the prohibition against state taxation is shown by its statutory context. Section 1333 generally declares the "[l]aws and regulations governing [OCS] lands." Subsection (a)(1) provides that "[t]he Constitution and laws and civil and political jurisdiction of the United States are extended to the * * * [OCS] * * * to the same extent as if the [OCS] were an area of exclusive Federal jurisdiction located within a State." As this Court has noted, Subsection (a)(2)(A) then "borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law" in order to "fill the substantial 'gaps' in the [statute's] coverage." *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 480 (1981); *Rodrigue* v. *Aetna Casualty Co.*, 395 U.S. 352, 357 (1969). Section 1333(a)(2)(A) specifically provides that, "[t]o the extent that they are applicable and not inconsistent with [federal law], the civil and criminal laws of each adjacent State * * * are declared to be the law of the United States for that portion of the * * * [OCS] * * * which would be within the area of the State if its boundaries were extended seaward to the outer margin of the [OCS]." It is in this context that Subsection (a)(2)(A) adds the final caveat,.upon which Shell relies, that "State taxation laws shall not apply to the [OCS]."

The statutory context suggests that Congress, in adding this final caveat, was addressing only the narrow question whether tax laws should be included among those state laws borrowed from adjacent States for application to the OCS. In unequivocally answering that question in the negative, Congress provided, in effect, that a State cannot

---

pany raising this issue is also pending in the Alaska courts. See J.S. 22 (citing *Amerada Hess Corp.* v. *Alaska Dep't of Revenue*, No. 3AN-84-05016 (Alaska 3d Cir. Super. Ct.)).

tax activities on the OCS as if those activities were occurring within the State's own jurisdictional borders. Section 1333(a)(2)(A) thus precludes a State from imposing a property tax on property (such as a drilling platform) located on the OCS; from imposing an excise tax on an event (such as extraction of oil) occurring on the OCS; or from imposing an income tax on income (such as earnings from a third-party sale) realized within the OCS. The statute, however, imposes no obvious restriction on the States' ability to tax events occurring or income realized within the continental United States, merely because the petroleum products refined or sold there are ultimately traceable to OCS oil. The statute, after all, says only that "State tax laws shall not apply to the OCS"; it does not purport to cloak OCS oil and gas with a perpetual tax immunity wherever it goes.[7]

Under longstanding principles of federal and state taxation, it is clear that Shell did not realize any income upon extracting OCS oil and placing the oil into its own

---

[7] Other, related provisions of OCSLA are consistent with this understanding of the preemptive scope of Section 1333(a)(2)(A). "In order to prevent the lessees from receiving a windfall in being relieved from paying a tax they contemplated paying when they bid in their leases with the States," 43 U.S.C. 1335(a)(9) provides that lessees must "pay[ ] to the Secretary [of the Interior] as an additional royalty on the production from the lease * * * a sum of money equal to the amount of the severance, gross production, or occupation taxes that would have been payable on such production to the State issuing the lease under its laws as they existed on August 7, 1953." S. Rep. 411, 83d Cong., 1st Sess. 3 (1953); see 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon). Significantly, Congress did not explicitly increase royalty payments by an amount equal to state income taxes that had previously been imposed on lessees' sales of OCS oil within state borders.

eline, any more than an automobile manufacturer lizes income upon producing an automobile and plac- it into its own truck for delivery to its own warehouse. ere is no formal "realization event" triggering the ognition of income in either circumstance. "Realiza- n" requires that a taxpayer exchange his property for nething of value (*Eisner* v. *Macomber*, 252 U.S. 189 20)), and, until Shell made such a disposition, its OCS remained mere work-in-process inventory. It is true t Shell, for internal accounting purposes, assigned a ue to its oil at the wellhead, and used this figure in essing the relative profitability of its exploration and oduction, as opposed to its downstream, operations. d it is also true that Shell used the fair market value of OCS oil as a "sales equivalent" for a variety of pur- ses, such as computing contract royalties, determining letion allowances, and computing the federal excise tax windfall profits. See J.S. 9 (referring to 26 U.S.C. 613, A, 4987 *et seq.*). But this is not to say that Shell "real- d income" upon transferring the oil from its production ision to its refining division, and Shell makes no con- tion to the contrary. See Reply Br. 4-5. In sum, because income in question was not realized on the OCS, Sec- n 1333(a)(2)(A) of OCSLA erects no bar to its taxation the States.[8]

In computing Shell's income tax, Florida of course permits Shell reat its OCS oil inventory as having a cost determined by those ex- ses it incurred in extracting the oil from the OCS. Florida simply ies that Shell is entitled to claim, for state tax purposes, an addi- al step-up in inventory cost on the basis of a hypothetical OCS . In our view, Florida's action is not precluded by OCSLA. Shell not made a transfer of the oil on the OCS, and Section 3(a)(2)(A) does not prevent Florida from treating net income ized on the subsequent sale of the oil in the fifty States as subject ax under Florida's unitary tax system.

2. The legislative history of the statute supports our reading of the statutory language. "Congress enacted OCSLA in the wake of decisions by this Court that the Federal Government enjoyed sovereignty and ownership of the [OCS] to the exclusion of adjacent States" (*Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 479 n.7). See *United States* v. *Texas*, 339 U.S. 707 (1950); *United States* v. *Louisiana*, 339 U.S. 699 (1950); *United States* v. *California*, 332 U.S. 19 (1947). Whether the laws of the adjacent States, including their power of taxation, should extend to the OCS as they had prior to those decisions, was the exclusive focus of congressional concern and debate. Congress nowhere evinced any intent to reduce the exposure of private lessees (such as Shell) to state income tax based on the lessees' sales of OCS oil within the States themselves.

a. Early bills, none of which was enacted, typically provided for the extension of the laws of the adjacent States, including their power of taxation, to the OCS. See, *e.g.*, H.R. 4484, 82d Cong., 1st Sess. § 8(a) (1951); 97 Cong. Rec. 9206 (1951); H.R. Rep. 695, 82d Cong., 1st Sess. 7, 13 (1951); Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan. L. Rev. 23, 29 & nn.28, 29 (1953). In the 83d Congress, a bill was introduced that would have permitted a more limited scope for state taxation, allowing the imposition only of severance or production taxes. See H.R. 4198, 83d Cong., 1st Sess. § 8(a) (1953); H.R. Rep. 215, 83d Cong., 1st Sess. 8 (1953). On the House floor, however, that provision was deleted and was replaced by the prohibition on state taxation that Shell relies upon in this case. See 99 Cong. Rec. 2511-2512, 2571, 2575 (1953).

The bill that eventually passed the Senate was S. 1901, and the process of its drafting reflects Congress's exclusive concern with the authority of adjacent States to treat, for income tax purpose, the OCS as property within their

rders. When first introduced, S. 1901 did not envision application of any state laws to the OCS, providing inad that the OCS should be governed by general prinles of federal maritime law. See S. 1901, 83d Cong., 1st ss. § 4(a) (1953). The bill was then amended in Committo adopt a new approach, which was the approach imately adopted by the Senate as a whole (see 99 Cong. c. 7265 (1953)). First, the reported bill provided that leral law should extend to the OCS "to the same extent if [it] were an area of exclusive Federal jurisdiction ated within a State" (S. Rep. 411, 83d Cong., 1st Sess. (1953)). Second, the reported bill adopted all "apcable and not inconsistent" laws of the adjacent States the governing federal law "for that portion of the [OCS] ich would be within the area of the State if its bounries were extended seaward" (*ibid.*). Hence, unlike lier legislative proposals, S. 1901 as reported *adopted* jacent state law as federal law, rather than formally *exding* adjacent state jurisdiction to the OCS. See *Gulf fshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 480; *drigue* v. *Aetna Casualty Co.*, 395 U.S. at 355-357; ristopher, *supra*, 6 Stan. L. Rev. at 39-43.

The Senate Committee also added a third provision to 1901, which was intended to ensure that the provisions t described would not be read as conferring any isdiction on adjacent States to extend their power of ation to the OCS. Section 4(a)(3) of the reported bill s provided in "precise unequivocal language" that he provisions of this section for adoption of state law he law of the United States shall never be interpreted as basis for claiming any interest in or jurisdiction on alf of any State for any purpose over * * * the [OCS], the property and natural resources thereof or the enues therefrom" (S. Rep. 411, *supra*, at 11, 16). The ompanying Senate Report explained that "under the ms of S. 1901, as reported, State taxation laws neces-

sarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any State" (*id.* at 3; see also 99 Cong. Rec. 6963-6964 (1953) (remarks of Sen. Cordon)).

The final version, drafted by the Conference Committee, simply added the House bill's express prohibition on state taxation to the federal-law scheme crafted by the Senate. See H.R. Conf. Rep. 1031, 83d Cong., 1st Sess. (1953); 99 Cong. Rec. 10419 (1953). During Senate discussion of the conference substitute, the Senate sponsor of the legislation expressed the view that the addition of the House language was "unnecessary" and that "[i]t add[ed] nothing to and took nothing from the bill as it passed the Senate." 99 Cong. Rec. 10471-10472 (1953) (remarks of Sen. Cordon). The legislative history therefore shows that Congress's addition of the House language evidenced no change in the congressional design, which was confined to eliminating the authority of the adjacent States to treat, for the purpose of asserting their power of taxation, the OCS as property within their borders.[9]

b. The legislative debates further attest to the limited purpose of the statutory language on which Shell relies. Proponents of state taxation argued that Congress should confer on the adjacent States taxation authority equivalent to that provided in the Mineral Lands Leasing Act of 1920, § 32, 30 U.S.C. 189, with respect to public lands within a state's borders. See, *e.g.*, 99 Cong. Rec. 2509-2510, 2535 (1953) (remarks of Rep. Wilson); *id.* at 7228 (remarks of Sen. Ellender). They argued that the

---

[9] We find no merit in Shell's suggestion (J.S. 15-16) that the terms of the Senate provision—now contained in Section 1333(a)(3)—support its claim that Congress harbored a broader purpose. Section 1333(a)(3) was included simply to ensure that the provisions for adoption of adjacent state law "shall never be interpreted" to support an extension of their taxation authority to the OCS (S. Rep. 411, *supra*, at 3).

lens imposed on adjacent States by OCS ac-
ies—particularly the use of public facilities by
loyees—justified state taxing authority. They accord-
supported amendments that would, in effect, "give
tal States the right to extend their jurisdiction to these
S] lands" (*id.* at 7230 (remarks of Sen. Ellender)). See
t 2505 (remarks of Rep. Willis); *id.* at 7228 (remarks
en. Ellender); *Outer Continental Shelf: Hearings on S.*
Before the Senate Comm. on Interior and Insular Af-
, 83d Cong., 1st Sess. 277-278 (1953) [hereinafter
te Hearings] (remarks of Sen. Long).

pponents of state taxation responded that the OCS,
g outside the three-mile limit, was not at all analogous
ublic land within a State's borders. They urged that ex-
on of the power of taxation beyond a State's borders
ld be "unconstitutional" and constitute "larceny" (see
ong. Rec. 2506 (1953) (remarks of Rep. Celler); *id.* at
(remarks of Rep. Machrowicz); *id.* at 2571-2572
arks of Rep. Keating)), and that it would confer a
fall upon the few adjacent States at the expense of the
djacent States (see *id.* 2523 (remarks of Rep.
no); *id.* at 2524 (remarks of Rep. Machrowicz)).

gnificantly, no opponent of taxation by the adjacent
s ever suggested that Congress should limit the States'
ority to tax income received from the sale within the
inental United States of oil products originating from
CS. To the contrary, they came close to refuting that
notion in responding to suggestions made by
sentatives of adjacent States that those States would
werless to raise revenues to offset the burdens caused
CS development. The sponsor of the legislation in the
te noted that "[t]he companies holding the leases will
to build and maintain very substantial shore installa-
within the abutting States, and such shore installa-
will be subject to local taxes" (99 Cong. Rec. 7254

(1953) (remarks of Sen. Cordon)). During Senate Hearings, Assistant Attorney General Rankin similarly explained that an adjacent State would be able "to tax the shore bases" and that, although the State "would not be collecting [a severance tax], * * * it certainly is getting lots of others" (*Senate Hearings* 661-662).[10]

3. For these reasons, we believe that the language and legislative history of Section 1333(a)(2)(A) lend no meaningful support to Shell's claim that Congress intended to preempt any state tax that might incidentally affect adversely federal leasing revenues. The legislative record suggests to us that maximization of economic return was not the driving force behind the legislation,[11] and that

---

[10] Shell errs in relying (J.S. 17) on Senator Long's apparent belief that, absent amendment of S. 1901, "employers of these workers are subject neither to the State's severance tax, property tax, nor the tax on corporate profits" (see 99 Cong. Rec. 7261 (1953) (remarks of Sen. Long); S. Rep. 411, *supra,* at 67 (minority report of Sen. Long)). Senator Long's statement was expressly premised on the assumption that a private lessee such as Shell would not be engaging in activities within the taxing State's borders. See *ibid.* Hence, Senator Long was not addressing the distinct issue, raised in this case, whether income received from a sale of OCS oil completed within a State's borders must be reduced by the net value of the oil when it was extracted from the OCS. In any event, any reliance on the "criticisms by the two Sentors from Louisiana, Ellender and Long," is misplaced because they both "opposed the bill that eventually became the OCSLA" (*Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 483). It is well settled that " '[t]he fears and doubts of the opposition are no authoritative guide to the construction of legislation.' " *Ibid.* (quoting *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951)).

[11] Congress recognized, of course, that extension of the adjacent States' power of taxation to the OCS would necessarily decrease federal revenues. See 99 Cong. Rec. 2571 (1953) (remarks of Rep. Keating). Those remarks do not, however, suggest that Congress intended to preempt all state taxes (or other state laws) that might incidentally affect federal revenues, even though the taxes fell on activities occurring within the State's own borders.

gress did not intend to impose such a sweeping restric-
on state taxing powers. Section 1333(a)(2)(A) simply
es plain that the OCS, for tax purposes, is an area of
sive federal jurisdiction outside the borders of any
e State. The effect of the statute is thus to codify the
titutional proscriptions, set forth in the Due Process
Commerce Clauses, against state efforts to tax values
lie outside their jurisdiction. See *Container Corp. of*
rica v. *Franchise Tax Bd.*, 463 U.S. at 164-165.
though we find Shell's preemption argument unper-
ve, we do not regard its position as being altogether
lous. Florida has conceded, as it must, that Shell's
of OCS oil to independent third parties, if completed
e OCS itself, are immune from state income taxation.
.S. App. 1-8. It might be argued from this premise
a corporation's sales of OCS oil to a related corpora-
if completed on the OCS itself, would likewise be im-
e from state income taxation, provided that the sales
orted with the norm of unrelated parties dealing with
other at arm's length. If that is so, Shell might con-
that a different result should not obtain merely
use the transfer occurs (as here) between divisions of a
ry corporation rather than between subsidiaries of a
nt corporation. It is of course well established under
federal tax laws that, "while a taxpayer is free to
nize his affairs as he chooses, nevertheless, once hav-
lone so, he must accept the tax consequences of his
e, whether contemplated or not." *Commissioner* v.
onal Alfalfa Dehydrating & Milling Co., 417 U.S.
149 (1974). But we can imagine a nonfrivolous argu-
that the policies of the Outer Continental Shelf
ls Act would not be furthered by such formal distinc-
.

e question presented here is not of great importance
ne United States, given Florida's concession that

come from sales completed on the OCS itself is exempt
om state tax under Section 1333(a)(3).[12] More specifical-
we are not concerned that state taxation of the sort in-
lved here will be "devastating to future federal lease
venues" (J.S. 20), nor do we think that such fiscal con-
lerations should govern OCSLA's proper interpretation
any event. The question presented, however, is assured-
of some importance to oil companies and to the States,
ven the magnitude of the off-shore leasing program.
vo Justices dissented from the decision of the Florida
preme Court (see J.S. App. 1-18 to 1-36), and the ques-
n is now pending in the courts of other States (see note
supra). This Court's disposition of the instant appeal, of
urse, will be binding in all future litigation on the issue.
us, although we do not believe that plenary review
ould be warranted if the case were here on writ of cer-
rari, we are unable to conclude that the federal question
completely "insubstantial."

---

[12] We are informed that the State of Iowa has refused to make this
ncession in Shell's lawsuit now pending in that State. See note 6,
ra. If the Iowa Supreme Court were to uphold state taxation of
nings from OCS sales, that holding would appear to be error and
uld, for that reason, be a stronger candidate for this Court's
iew.

CONCLUSION

Probable jurisdiction should be noted.
Respectfully submitted.

CHARLES FRIED
Solicitor General
MICHAEL C. DURNEY
Acting Assistant Attorney General
ALBERT G. LAUBER, JR.
Deputy Solicitor General
RICHARD J. LAZARUS
Assistant to the Solicitor General
RICHARD FARBER
STEVEN W. PARKS
Attorneys

OCTOBER 1987

U.S. GOVERNMENT PRINTING OFFICE: 1987—202 037/60075

Supreme Court, U.S.
FILED
OCT 27 1987
JOSEPH F. SPANIOL, JR.
CLERK

(5)

No. 86-1593

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1987

SHELL OIL COMPANY,

Appellant

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA

Appellee

On Appeal from the
Supreme Court of Florida

Appellee's Supplemental Brief in Response to Amicus Curiae

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32399-0100
(904)488-0712

COUNSEL OF RECORD FOR APPELLEE

Robert A. Butterworth
Attorney General
Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahassee, Florida 32399-1050
(904)487-2142

OF COUNSEL

12 pp

TABLE OF CONTENTS

Page

TABLE OF CONTENTS.....i

TABLE OF AUTHORITIES.....ii

POINTS I AND II.....1

POINT I. THE DECISION OF THE SUPREME COURT OF FLORIDA IS CORRECT AND WHOLLY CONSISTENT WITH THE VIEWS OF THE UNITED STATES AS EXPRESSED IN THE SOLICITOR GENERAL'S AMICUS BRIEF.

POINT II. THIS CASE DOES NOT PRESENT A PROPER SUBSTANTIAL FEDERAL QUESTION BECAUSE THE QUESTION PRESENTED IN THE JURISDICTIONAL STATEMENT IS FLAWED AND BECAUSE THE CONCLUSION OF THE SOLICITOR GENERAL THAT THE APPEAL IS NOT ALTOGETHER FRIVOLOUS IS NOT SUPPORTED BY ANY VIABLE ARGUMENT.

DISCUSSION.....1

CONCLUSION.....9

TABLE OF AUTHORITIES

PAGE

CASES:

Continental Oil Company v. Federal Power Commission, 370 F.2d 57 (5th Cir. 1966) 2, 4

Hicks v. Miranda, 422 U.S. 332 (1975) 8

Jeff Busby v. Electric Utilities Employees, 323 U.S. 72 (1978) 5

Union Oil Company of California v. Morton, 512 F.2d 743 (9th Cir. 1975) 3

United States v. Maine, 420 U.S. 515 (1975) 3

White v. Johnson, 282 U.S. 367 (1931) 7

STATUTES:

43 U.S.C., s. 1333(a)(2)(A)(1970) 1

I.R.C. s. 7701(1) 6

I.R.C. s. 7701(14) 6

OTHER:

R. Stern, E. Gressman, and S. Shapiro, Supreme Court Practice, (6th Ed.)(1986) 5, 7

POINTS I AND II

POINT I. THE DECISION OF THE SUPREME COURT OF FLORIDA IS CORRECT AND WHOLLY CONSISTENT WITH THE VIEWS OF THE UNITED STATES AS EXPRESSED IN THE SOLICITOR GENERAL'S AMICUS BRIEF.

POINT II. THIS CASE DOES NOT PRESENT A PROPER SUBSTANTIAL FEDERAL QUESTION BECAUSE THE QUESTION PRESENTED IN THE JURISDICTIONAL STATEMENT IS FLAWED AND BECAUSE THE CONCLUSION OF THE SOLICITOR GENERAL THAT THE APPEAL IS NOT ALTOGETHER FRIVOLOUS IS NOT SUPPORTED BY ANY VIABLE ARGUMENT.

DISCUSSION

The Solicitor General's brief fully supports and confirms the decision of the Supreme Court of Florida that the State of Florida is not prohibited by the Outer Continental Shelf Lands Act, 43 U.S.C., s. 1333(a)(2)(A)(1970) from imposing a tax upon its apportioned share of income derived from the sale in the various states of the United States of oil extracted from the Outer Continental Shelf.

As to the merits of this case the

icitor General stated:

> In our view, the Florida Supreme Court--the first state supreme court to address the issue--correctly rejected Shell's preemption claim.

s the Solicitor General's view is in
l harmony with the interpretation of
State of Florida. Moreover other
eral courts have recognized that the
eral preemption is limited to taxation
activities and property beyond the
ee mile limit.

In the instant case, there is no
flict between the Outer Continental
lf Lands Act ("OCSLA") and the Florida
porate tax provisions. The purpose of
LA has been explained by the Fifth
cuit Court of Appeals in the case of
tinental Oil Company v. Federal Power
mission, 370 F.2d 57, 67 (5th Cir.
6), reh. den., January 27, 1967 which
ted:

> Congress passed the OCSLA solely to regulate the "leasing and

development...of the oil potential of the Continental Shelf." H.R. Rep. No. 413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad. News, p. 2178 (1953). (e.s.)

The legislative intent behind OCSLA has also been explored by the Ninth Circuit Court of Appeals in Union Oil Company of California v. Morton, 512 F.2d 743, 747 (9th Cir. 1975) which stated that:

> Oil and gas deposits beneath the continental shelf are precious resources belonging to the entire nation. Congress, although encouraging the extraction of these resources by private companies, provided safeguards to insure that their exploitation should inure to the benefit of all.
>
> * * *
>
> Careful study of the Act confirms that Congress intended to exercise both proprietary powers of a landowner and the police powers of a legislature in regulating leases of publicly owned resources. (e.s.)

The United States v. Maine, 420 U.S. 515, 527 (1975), the United States Supreme Court ended States'

pts to offer leases on the OCS and
d that OCSLA "provided for the
ly development of offshore
rces." This result is consistent
the legislative purpose of the OCSLA
y to regulate the leasing, and
opment of the oil potential of the
Continental Oil, supra.

Other federal courts having properly
icted the application of the federal
ption, no purpose exists for this
to grant plenary review herein.

The Department reasserts that the
llant's jurisdictional statement
ged the question presented beyond
addressed by the Florida courts to
ude hypothetical elements. Further,
Appellant in its reply brief did not
ect the flaw but characterized its
per inclusions as irrelavancies.
efore, the Appellant has not
ented a proper federal question to

is Court. Standing alone an improperly esented question is grounds for smissal.[1]

Moreover, as this Court stated in eff Busby v. Electric Utilities nployees, 323 U.S. 72, 75 (1978):

> It is not the function of the certificate authorized by 28 USCA ss. 346, 8 FCA title 28, ss. 346, to require this Court to answer questions not shown to be necessary to the decision of the case. A question will not be answered if it is hypothetical....

Finally, it is the Department view hat this case presents no substantial ederal question and neither the

---

[1] As stated in R. Stern, E. Gressman nd S. Shapiro, Supreme Court Practice, 298 (6th ed.) (1986):

> If there is such a jurisdictional defect (such as a decision by other than the highest state court in which decision can be had, or the existence of an adequate state ground, or a failure to present properly the federal question...the appeal will be dismissed summarily without considering the appeal papers as a petition for certiorari....)

Appellant nor the Amicus provides any viable argument to justify plenary consideration.

The Amicus Curiaes brief, in discussing the difference in transactions between divisions of a unitary corporation as contrasted to those between subsidiaries of a parent corporation, states:

> But we can imagine a nonfrivolous argument that the policies of the Outer Continental Shelf Lands Act would not be furthered by such formal distinctions....

The Department cites Sections 7701(14) and (1) from the Internal Revenue Code of 1986:

> (14)TAXPAYER-The term "taxpayer" means any person subject to any internal revenue tax.
>
> (1)PERSON-The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Thus for federal income tax law there is no recognition of divisions of a

corporation as separate entities and none is visible in OCSLA. To bifurcate a corporation would be repugnant to these federal provisions. Moreover, for income tax purposes states are bound to respect the separateness and wholeness of each entity barring a specific provision to the contrary. Therefore, this speculation of the amicus is academic.

As stated in R. Stern, E. Gressman & S. Shapiro, Supreme Court Practice, p. 145 (1986):

> The jurisdictional requirement relative to the raising of a substantial federal question is formalized in the various subsections of s. 1257. Thus it is necessary, in an appeal under subsections (1) and (2), that the validity of a federal treaty or statute or of a state statute have been "drawn in question."

This assertion is supported by the following statement made at p. 146 therein:

> See also White v. Johnson, 282 U.S. 367, 373 (1931), where the Court

stated that the constitutionality of a statute "is not drawn in question except in connection with its application to some person, natural or artificial," thus excluding academic questions about the statute.

The Department respectfully suggests that the decision of the Supreme Court of Florida was correct and that, therefore, the disposition of this case by dismissal is appropriate and adequate. Hicks v. Miranda, 422 U.S. 332, 343 (1975).[2]

[2] Therein this Court stated:

> We agree with appellants that the District Court was in error in holding that it could disregard the decision in Miller II. That case was an appeal from a decision by a state court upholding a state statute against federal constitutional attack. A federal constitutional issue was properly presented, it was within our appellate jurisdiction under 28 U.S.C. ss. 1257(2), and we had no discretion to refuse adjudication of the case on its merits as would have been true had the case been brought here under our certiorari jurisdiction. We are not obligated to grant the case plenary consideration, and we did not; but we were required to deal with its merits. We did so by concluding that the appeal should be dismissed because the constitutional challenge to the California statute was not a substantial one.

CONCLUSION

For the reasons stated herein and in its Motion to Dismiss or Affirm the Department asserts that there is no proper substantial federal question before this Court requiring plenary consideration and therefore the Department respectfully requests that this Court grant its Motion to Dismiss and Affirm the decision of the Supreme Court of Florida.

Respectfully submitted,

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32301

COUNSEL OF RECORD FOR APPELLEE

ROBERT A. BUTTERWORTH
ATTORNEY GENERAL

Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahassee, Florida 32399-0150
(904)488-0712

OF COUNSEL

DISTRIBUTED
NOV 3 1987

No. 86-1593

Supreme Court, U.S.
FILED
OCT 30 1987
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY,
Appellant

v.

DEPARTMENT OF REVENUE, STATE OF FLORIDA,
Appellee

REPRINTED COPY

On Appeal from the Supreme Court of Florida

SUPPLEMENTAL MEMORANDUM FOR THE APPELLANT

J. LLOYD KENNEDY
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 79252
(713) 241-3386
Of Counsel

ARTHUR J. ENGLAND, JR.
Fine Jacobson Schwartz Nash Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200
Attorney for Appellant

In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1593

SHELL OIL COMPANY,
Appellant

v.

DEPARTMENT OF REVENUE, STATE OF FLORIDA,
Appellee

On Appeal from the Supreme Court of Florida

SUPPLEMENTAL MEMORANDUM FOR THE APPELLANT

Appellant Shell Oil Company submits this supplemental memorandum pursuant to Rule 16.6 of the Rules of this Court to call the Court's attention to a recent decision of the Supreme Court of Iowa. *Shell Oil Company* v. *Iowa Department of Revenue*, No. 86-1565 (Oct. 21, 1987).*

1. The issue in this case is whether the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333(a)(2)(A), prohibits the states from taxing income earned from the sale of oil and gas extracted from the outer Continental Shelf. The State of Florida conceded below that "any revenues which Shell derives from actual sales consummated *on the OCS oil platforms* are beyond the

---

* A copy of this decision is attached.

reach of Florida's taxing power as limited by Section 1333(a)(2)." J.S. App. 1-8 (emphasis added). The State contended, however, that it could tax Shell's income "derived from sales of OCS oil actually made within the boundaries of the fifty states." *Ibid.* The Supreme Court of Florida upheld the State's position by a divided vote.

2. On October 16, 1987, the Solicitor General filed an *amicus curiae* brief recommending that the Court note probable jurisdiction of Shell's appeal. Although the Solicitor General agreed with the Florida Supreme Court's decision, he concluded that the legal issue was debatable and that the question presented therefore was substantial "given the magnitude of the off-shore leasing program." U.S. Br. 17.

Moreover, the Solicitor General expressly remarked that Florida's concession that it could not tax Shell's sales of OCS oil, if completed on the OCS itself, was mandated by the federal statute (U.S. Br. 6):

> The statutory language, the structure of the statute, and the relevant legislative history [of the OCSLA] show that Congress intended in OCSLA to bar any state from subjecting activities on the OCS to taxation as if the OCS were located within the State's borders. A State, therefore, may not impose a severance, production, property, or sales tax on Shell's activities on the OCS. Nor, as Florida has properly conceded (see J.S. App. 1-8), may a State, consistently with the Supremacy Clause, tax income earned by Shell from OCS oil or gas sales that are completed on the OCS itself.

Finally, the Solicitor General contrasted the Florida case with identical litigation involving Shell's state income tax obligations then pending in the Supreme Court of Iowa (U.S. Br. 17 n.12):

> We are informed that the State of Iowa has refused to make this concession in Shell's lawsuit now pending in that State. * * * If the Iowa Supreme Court

were to uphold state taxation of earnings from OCS sales, that holding would appear to be error and would, for that reason, be a stronger candidate for this Court's review.

3. On October 21, 1987, the Supreme Court of Iowa issued its decision concerning the Iowa Department of Revenue's assessment of Shell's tax liability on income derived from OCS sales. The Iowa court upheld the State's claim that it may tax its apportioned share of *all* of Shell's earnings, *including* earnings from sales of OCS products that occurred on the Shelf itself:

> The facts of the present case differ slightly from those in the [Florida] case because the Florida revenue officials had excluded from their apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands. In the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS. *We do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court.*

App., *infra*, 10a (emphasis added). Thus, the Iowa Supreme Court has reached a decision that, according to the Solicitor General, is in error, is contrary to the interests of the United States, and warrants this Court's review. See U.S. Br. 16-17 & n.12.

4. Shell has determined to seek further review of the Iowa Supreme Court's decision and, in order to permit the Court to consider the two cases together without undue delay, it intends to file a notice of appeal and a jurisdictional statement no later than December 15, 1987. The question therefore becomes whether the Court should note probable jurisdiction in the Florida case, as the Solicitor General has recommended, and then consolidate that proceeding with the appeal to be filed in the Iowa case, or

whether the Court should await the Iowa appeal and then either consolidate the cases or hold the Florida appeal and dispose of it as appropriate in light of the Court's ruling on the Iowa appeal. We suggest that the latter course would be preferable.

The Solicitor General's *amicus curiae* brief, and the recent decisions of the Florida and Iowa Supreme Courts, demonstrate the urgent need for this Court to resolve the question of the states' authority to tax the income derived from the sale of oil and gas extracted from the outer Continental Shelf. The Iowa case would appear to be a far better vehicle in which to provide that definitive resolution. The Iowa case presents the precise issue posed by the Florida appeal, but it also presents the additional important issue whether states may tax the income resulting from sales occurring on the OCS itself. As a result, the Court's resolution of the Iowa appeal will also govern resolution of the Florida appeal.

Accordingly, because the Iowa appeal provides a better vehicle for resolving the important legal issues presented in these cases, the Court may wish to defer consideration of the Florida appeal pending the filing of the Iowa appeal.

Respectfully submitted.

J. LLOYD KENNEDY
Corporate Tax Counsel
Shell Oil Company
One Shell Plaza
Houston, Texas 79252
(713) 241-3386
Of Counsel

ARTHUR J. ENGLAND, JR.
Fine Jacobson Schwartz Nash Block & England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200
Attorney for Appellant

OCTOBER 1987

APPENDIX

APPENDIX

IN THE SUPREME COURT OF IOWA

[Filed October 21, 1987]

KELLY-SPRINGFIELD TIRE CO.,
Appellant,

vs.

IOWA STATE BOARD OF TAX REVIEW,
Appellee.

SHELL OIL COMPANY,
Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

247

87-278
86-1565

---

ls from the Iowa District Court for Polk County,
nato and Joel D. Novak, Judges.

lidated appeals by corporate taxpayers in actions
cial review of assessments of additional income
r Iowa Department of Revenue. (NO. 87-278)
SED AND REMANDED; (NO. 86-1565) AF-
D IN PART, REVERSED IN PART AND RE-
D.

Burns Mossman of Nyemaster, Goode, McLaughlin, Emery & O'Brien, P.C., Des Moines, for appellant, Kelly-Springfield Tire Co.

J. Lloyd Kennedy and William D. Peltz, Houston, Texas and James W. Hall of Hall & Irvine, Cedar Rapids, for appellant Shell Oil Company.

Thomas J. Miller, Attorney General, Harry M. Griger, Special Assistant Attorney General, and Gerald A. Kuehn, Assistant Attorney General, for appellee.

Considered en banc.

CARTER, J.

These consolidated appeals raise two legal issues in regard to income tax assessments by the Iowa Department of Revenue (IDOR) being judicially reviewed under Iowa Code section 17A.19 (1985). These issues are: (1) whether assessment of additional corporation income taxes by IDOR against appellant Kelly-Springfield Tire Co. (Kelly-Springfield) in No. 87-278 and appellant Shell Oil Company (Shell) in No. 86-1565, made more than three years after the filing of the taxpayers' returns, was untimely under Iowa Code section 422.25(1) (1977) and therefore invalid; and (2) whether assessment of additional income taxes against Shell in No. 86-1565 was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333(a). For reasons hereafter stated, we answer the first question in the affirmative and the second question in the negative, thus, affirming in part and reversing in part the decisions of the district court.

I. *Timeliness of Assessments Under Iowa Code Section 422.25(1) (1977).*

The record supports the taxpayers' contention that assessment of additional corporate income taxes by IDOR against Kelly-Springfield for the years 1971-78, inclusive,

and against Shell for the years 1975-77, inclusive, were initiated more than three years after those taxpayers had filed corporate income tax returns for the years in question. Consequently, both Kelly-Springfield and Shell have contended both before the agency and throughout these judicial review proceedings that these assessments were untimely under Iowa Code section 422.25(1) (1977) and thus invalid.

Section 422.25(1) provides:

> As soon as practicable and in any event within three years after the return is filed the department shall examine it and determine the correct amount of tax, and the amount so determined by the department shall be the tax; provided that if the taxpayer omits from income such an amount as will, under the Internal Revenue Code of 1954, extend the statute of limitations for assessment of federal tax to six years under said Code, the period for examination and determination shall be six years; and provided further that the period for examination and determination shall be unlimited in the case of a false or fraudulent return with intent to evade tax or in the case of failure to file a return. Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months to make an examination and determination from the date of receipt by the department of notice from the taxpayer of the final disposition of any matter between the taxpayer and the internal revenue service with respect to the particular tax year.

For each of the tax years in controversy, the Internal Revenue Service (IRS) had audited the taxpayers' returns. The additional assessments of Iowa income taxes were made within six months of receipt by IDOR of notice of the final disposition of the federal audit for the particular tax year. These additional assessments of

Iowa income taxes, except for certain adjustments in Kelly-Springfield's tax liability for 1971, were unrelated to and not affected by any changes made in connection with the audit of the taxpayers' federal income tax liabilities.

The issue which was framed at the contested case hearing was whether IDOR's right of examination and determination of additional state tax liability during the extended six-month period following the conclusion of a federal audit is unlimited in scope or is limited to corrections resulting from action taken in the federal audit. Following the contested case hearing, IDOR concluded that its right of examination and determination for six months following a federal audit is unlimited in scope. The district court agreed with that conclusion.

The primary argument advanced by IDOR to sustain its interpretation is that the words "examination and determination," which appear several times within section 422.25(1), are in no instance qualified with respect to the scope of the inquiry IDOR is permitted to make. Because the scope of the examination and assessment of additional tax is concededly unlimited in the other circumstances where the phrase "examination and determination" appears in the statute, IDOR argues that consistency in the application of identical statutory language requires an unlimited examination also be permitted in the present situation.

In response to this argument, the taxpayers urge that an exception to a general period of limitation which is triggered by the occurrence of a particular event must be interpreted in some manner which is relevant to that event. The mere occurrence of a federal audit is not, taxpayers argue, relevant to whether the limitation period for imposing state tax liability should be extended. It only becomes relevant, they suggest, if action taken in the federal audit alters some basic premise on which the taxpayer's state tax liability was initially reported.

We find the taxpayers' interpretation to be more plausible than the one proposed by IDOR. A court construing a statute to ascertain legislative intent must not only consider the language used, but must also take account of the object sought to be accomplished or the problems sought to be remedied and arrive at a construction that will best effect its purpose. *Matter of Girdler*, 357 N.W.2d 595, 597 (Iowa 1984); *In Interest of G.R.*, 348 N.W.2d 627, 631 (Iowa 1984); *Lau v. City of Oelwein*, 336 N.W.2d 202, 203 (Iowa 1983).

The extended period of examination following the conclusion of a federal audit was inserted in section 422.25 (1) by 1957 Iowa Acts chapter 211, section 1. The determination of the primary objective of such an amendment requires reference to the prior state of the law and the circumstances surrounding the amendment's enactment. *City of Des Moines v. Public Employment Relations Bd.*, 275 N.W.2d 753, 760 (Iowa 1979). Applying these principles to the present case it appears that, prior to the enactment of the 1957 amendment, it was established as the legislative policy of this state that examination and determination of the proper amount of tax was to be made by IDOR within three years of the filing of the taxpayer's return except in certain situations of taxpayer omission not relevant here.[1] The interpretation proposed by IDOR is, we believe, incompatible with the basic premise upon which section 422.25(1) is based, *i.e.*, that unless certain enumerated circumstances have occurred which preclude the agency from making an accurate assessment of Iowa taxes within the three-year period its right of examination is barred.

We find nothing in the 1957 amendment which suggests a retreat from this overriding policy. Rather, the federal

---

[1] This policy has existed for more than 50 years. Beginning in 1934, the limitation period was established at two years. 1934 Iowa Acts ch. 82, § 21 (45 Ex. G.A.). It was increased to three years in 1955. 1955 Iowa Acts ch. 210, § 1.

audit exception to the three-year limitation appears to be a fair way of dealing with changed circumstances resulting from the federal examination. The exception is therefore available to IDOR only if adjustments made by the internal revenue service create a change of circumstances affecting the taxpayer's Iowa tax liability. The rather short period of time granted IDOR to make adjustments of Iowa tax liability following the conclusion of the federal inquiry supports our conclusion that the examination is limited in scope.[2]

In *Commonwealth v. Lukens Steel Co.*, 402 Pa. 304, 167 A.2d 142 (1961), the court interpreted a Pennsylvania statute which provided that,

> [I]f at any time the net income as returned by any corporation to the federal government is finally changed or corrected by the commissioner of internal revenue or by any other agency or court of the United States with a result that tax, in addition to the amount paid, is due under this act, the department is hereby authorized and empowered to make a resettlement of the tax due by such corporation, based upon the facts contained in the report, or upon any information within its possession or that shall come into its possession.

Pa. Stat. Ann. Tit. 72, § 3402h(c) (Purdon 1964). Notwithstanding the rather broad language in the final sentence of the statute, the court reasoned that its legal effect was to extend the limitation period only for pur-

---

[2] Another factor which suggests that the legislature intended a limited scope of examination is that legislative enactments contained in 1955 Iowa Acts ch. 210, § 2, which shifted to the state the burden of proof in areas where the right of examination is unlimited, were not made applicable to the extended period of examination following a federal audit. This suggests a legislative intent that the factual basis for reexamination of Iowa tax liability in the latter situation would turn on the result of the federal audit and not involve other areas of disputed fact.

poses of making assessments of state income taxes due as a result of federal adjustments. The court indicated a contrary ruling would render absolutely meaningless the provisions of the act establishing a general time limit for resettlement. 402 Pa. at 309-10, 167 A.2d at 145. *See also McLean Trucking Co. v. Lindley*, 70 Ohio St. 2d 106, 111, 435 N.E.2d 414, 417 (1982) (general limitation period absolute bar to assessment of additional state taxes unrelated to corrections made by internal revenue service).

IDOR argues that, notwithstanding the matters which we have discussed, its long-standing interpretation of the statute should be given some weight. Although the interpretation of the statute proposed by IDOR in the present case may have been the department's position for some time, it should be noted that it has issued no published rule or directive codifying that position. As we have stated in another revenue case involving statutory interpretation, "the meaning of a statute is always a matter of law, and final construction and interpretation . . . is for this court." *Sorg v. Iowa Dep't of Revenue*, 269 N.W.2d 129, 131 (Iowa 1978). *See also City of Des Moines*, 275 N.W.2d at 759-60. We hold that any adjustment by IDOR to the taxpayers' liability in the present cases which was not initiated within three years following the filing of returns was untimely and invalid except as it relates to changes required by the federal audit. This requires a reversal of No. 87-278 and a reversal of No. 86-1565 on this issue.

II. *Claims Involving Taxation of Revenues Derived From Outer Continental Shelf Lands.*

The next issue, involving only claims by Shell in No. 86-1565, concerns an alleged limitation on the power of the states to tax activities occurring on outer continental shelf (OCS) lands which Shell suggests is contained in the Outer Continental Shelf Lands Act, 43 U.S.C. section 1333(a).

The record reflects that Shell is a Delaware corporation engaged in a unitary business consisting of exploration for oil and the development, production, transportation, purchase and marketing of crude oil, natural gas, and chemical products. During the years at issue, certain of Shell's gross revenues were derived from sale of products extracted from OCS lands. During this period, Shell sold all of its OCS natural gas at the platform on OCS lands. In contrast, most of Shell's crude oil was transferred off OCS lands to other locations prior to being marketed. Shell's principal business in Iowa during this period consisted of marketing oil and chemical products which had been refined and manufactured outside Iowa.

In accordance with Iowa Code section 422.33(2)(b)(4), Shell's Iowa net income was derived by application of an apportionment formula wherein "the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales." Because its gross revenues for these years contained amounts realized from the disposition of OCS products, Shell maintains that it was improper for the state of Iowa to give any consideration to revenue from OCS sources in the application of the statutory apportionment formula utilized to determine its Iowa income tax liability.

In advancing this argument, Shell relies upon language contained in subparagraphs 2(A) and (3) of section 1333(a) of the OCSLA, which provides, in part, as follows:

> (2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer

> Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of the applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the outer Continental Shelf. . . .*
>
> (3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, *or the property and natural resources thereof or the revenues therefrom.*

(Emphasis added.) Shell views the foregoing statutes as a Congressional directive designating any return from its OCS land transactions as federally protected income and, therefore, not includable in the Iowa tax base. In so arguing, it relies upon the decisions of *Aloha Airlines, Inc. v. Director of Taxation of Hawaii*, 464 U.S. 7, 104 S. Ct. 291, 78 L. Ed. 2d 10 (1983), and *Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 103 S. Ct. 3394, 73 L. Ed. 2d 1194 (1982).

We do not agree that these cases support Shell's contentions. The policies underlying the federal legislation applied in the *Aloha Airlines* and *Ramah Navajo School Board* cases were clearly indicated to be such that the application of local taxing statutes would have undeniably frustrated the goals which Congress was attempting to promote. In contrast, Shell has indicated no particular area of Congressional policy in the management and control of the OCS lands which is frustrated by the state of Iowa applying a traditional measure of apportionment

in order to obtain a valid local nexus for taxation purposes.[3]

The issue is, of course, entirely one of statutory interpretation. The Florida Supreme Court in *Shell Oil Co. v. Department of Revenue*, 496 So. 2d 789, 791 (Fla. 1986), has rejected the interpretation which Shell seeks to place on 43 U.S.C. sections 1333(a)(2)(A), (3). In that case, the court concluded that the realization of the income by Shell occurred within the legislative jurisdiction of the taxing state. The facts of the present case differ slightly from those in the cited case because the Florida revenue officials had excluded from their apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands. In the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS. We do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court.

In reviewing the legislative history of the OCSLA, we are convinced that the language restricting the application of state taxation laws to the OCS and denying to the state any interests in the natural resources or revenues from the seabed and subsoil of the OCS was intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS. The legislation in question was the culmination of an historical tug-of-war between state and federal in-

---

[3] In defining the term "unitary business" for purposes of apportioning income, Iowa Code § 422.32(5) refers to a business carried on partly within and partly without a state where the portion of the business carried on within the state depends on or contributes to the business outside the state. Section 432.32(10) defines "State" so as to include "any territory or possession of the United States." We conclude that the OCS lands are a territory of the United States so as to be includable within this definition.

terests in the region. In a pertinent report on the legislation by the Senate committee, it was stated:

> It is the Committee's collective judgment that under the terms S. 1901 as reported, State taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state. Paragraph (3) of Section 4(a) specifically commands that—
>
> > The provisions of this section for adoption of the State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any state for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.

S. Rep. No. 411, 83rd Cong., 1st Sess. (1953).

Iowa's imposition of the challenged corporation income taxes on Shell for the years 1975-80, inclusive, is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.[4] This principle was illustrated in *Moorman Manufacturing Co. v. Bair*, 254 N.W.2d 737 (Iowa 1977), *aff'd*, 437 U.S. 267 (1978). In further amplifying the principles established in its affirming opinion in *Moorman*, the Supreme Court stated in *Mobile Oil*

---

[4] In this regard, the nature of the tax differs substantially from the "first-use" tax involved in *Maryland v. Louisiana*, 451 U.S. 725, 101 S. Ct. 2114, 68 L. Ed. 2d 576 (1981). Shell's reliance on that case is also misplaced because it was not decided under the OCSLA but instead involved the Natural Gas Policy Act.

Corp. v. Commissioner of Taxes, 445 U.S. 425, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980):

> "[T]he entire net income of a corporation generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." [citing *Morman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197, 204 (1978)] . . . The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State, and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction."

Id. at 436-37, 100 S. Ct. at 1231, 63 L. Ed. 2d at 520 (other citations omitted).

Shell's argument that somehow the source of the revenues prohibits their inclusion in the apportionment formula is only valid if it was the intent of Congress to prohibit that result. In seeking to determine that intent, we begin with the recognition that the pattern of apportionment of gross revenues, regardless of source, for purposes of determining local taxability is well established within our federal system. As observed in *Mobile Oil Corp.*:

> In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. . . . In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to

> account for contributions to income resulting from functional integration, centralization of management, and economies of scale. . . . Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.

Id. at 438, 100 S. Ct. at 1232, 63 L. Ed. 2d at 521 (citations omitted).

In deciding whether Iowa's taxing statutes offend against Congressional policies of management and control of OCS lands, it is preferable, we believe, to focus on the tax consequences which are produced by applying the apportionment formula rather than focusing on the various elements which are inserted into the equation in order to produce those consequences. Shell's argument fails to indicate how the impact of applying the apportionment formula detracts in any identifiable way from Congressional policy relating to OCS lands.

The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment formula contained in Iowa Code section 422.33(2)(b)(4) apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities.[5] That, of course, is the goal of any apportionment formula. We cannot attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA. We fail to devine any such intention from either the legislative history or language of the Act. We conclude that the district court properly rejected Shell's petition for judicial review on this issue.

---

[5] See n.3, *supra*.

Based upon our determination of the issues presented, the judgment of the district court in No. 87-278 is reversed and that case is remanded to the agency for further proceedings not inconsistent with this opinion. The judgment of the district court in No. 86-1565 is in all respects affirmed on the issues involving application of 43 U.S.C. section 1333(a) and is reversed on the issues involving the application of Iowa Code section 422.25(1). As to the latter issues, the case is remanded to the agency for further proceedings not inconsistent with this opinion. The costs of appeal in No. 87-278 are taxed to appellee. The costs of appeal in No. 86-1565 are taxed seventy-five percent to appellant and twenty-five percent to appellee.

(NO. 87-278) REVERSED AND REMANDED; (NO. 86-1565) AFFIRMED IN PART, REVERSED IN PART AND REMANDED.

All justices concur except Snell, J., who takes no part.

Supreme Court, U.S.
FILED
NOV 20 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1593

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1987

SHELL OIL COMPANY,

Appellant

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA

Appellee

Supplemental Brief for the Appellee

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32399-0100
(904)488-0712

COUNSEL OF RECORD FOR APPELLEE

Robert A. Butterworth
Attorney General
Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahassee, Florida 32399-1050
(904)487-2142

OF COUNSEL

TABLE OF CONTENTS

Table of Contents i

Table of Authorities ii

Argument 1

"Iowa" 1

"Florida" 3

Obfuscation and Delay 7

Conclusion 12

Appendix

(a) Tropicana Products, Inc., v. Dept. of Revenue, Case No. CA-17-1799 (12th Judicial Cir., Manatee County, Florida, November 22, 1976) . . 1a

TABLE OF AUTHORITIES

Cases:

Hicks v. Miranda, 422 U.S. 332 (1975) 14

Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980) 13

Shell Oil Company v. Iowa Department of Revenue, No. 86-1565 (Oct. 21, 1987) 1

Tropicana Products, Inc. v. Dept. of Revenue, Case No. CA-17-1799 (12th Judicial Cir. Manatee County, Florida) aff. Per Curiam 353 So.2d 686 (Fla. 2nd DCA, 1977), Appendix 1a 7

Argument

Appellee, the Department of Revenue, State of Florida, submits this supplemental brief pursuant to Rule 16.6 of the Rules of this Court to oppose Shell's suggestion that this Court consolidate the case at bar ("Florida") with Shell Oil Company v. Iowa Department of Revenue, No. 86-1565 (Oct. 21, 1987) ("Iowa"). Such consolidation would be inappropriate and would permit Shell further opportunity to obfuscate the single legal issue present in "Florida".

"IOWA"

To identify the dissimilarities distinguishing the two cases, the following extracts from the decision of the Iowa Supreme Court are pertinent:

1. "The record (indicates) that assessment of additional corporate income taxes ... against Shell for the years 1975-1977, inclusive ...."[1]

---

[1]Shell Supp. Memo. App. 2a.

2. "During this period, Shell sold all of its OCS natural gas at the platform on OCS lands. In contrast, most of Shell's crude oil was transferred off OCS lands to other locations prior to being marketed."[2]

3. "Shell has indicated no particular area of Congressional policy in the management and control of the OCS lands which is frustrated by the state of Iowa applying a traditional measure of apportionment in order to obtain a valid local nexus for taxation purposes."[3]

4. "The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus."[4]

5. "The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment formula ... apparently aids in obtaining an accurate measure of the tax to be imposed ...."[5]

From the foregoing, the following conclusions may be fairly adduced:

---

[2]Shell Supp. Memo. App. 8a.

[3]Shell Supp. Memo. App. 9a.

[4]Shell Supp. Memo. App. 11a.

[5]Shell Supp. Memo. App. 13a.

1. The time-frame in "Iowa" is the tax years 1975-1977 inclusive;

2. Shell did establish that it had realized some indeterminate amount of revenues from sales of natural gas upon the OCS;

3. The Iowa Department of Revenue had included revenues from such sales in Shell's pre-apportionment tax base; and

4. The Iowa decision in major part addresses the propriety of the apportionment method applied.

"FLORIDA"

The essential disparaties with "Iowa" are clearly discernible in the following extracts from the record in "Florida".

The final judgment of the Circuit Court for Leon County states:

> 1. "This case involves Florida corporate income taxes for Shell ... for the years 1972 through 1975.[6]

---

[6]J.S. App. 3-1.

2. After deciding the motions for summary judgment, only one issue remained for determination, i.e., whether Shell's income derived from its production business on the Outer Continental Shelf ('OCS') should be apportioned by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the 'Apportionment Formula') or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in the denominators of the Apportionment Formula. Although this issue was originally part of Shell's motion for summary judgment, Shell withdrew this issue prior to the summary judgment hearing .... Shell has now filed a motion to amend to delete its prayer for relief relating to this withdrawn issue ...."[7]

Thus, Shell by its two amendments waived both the controverted factual issue of consumation of any sales upon the OCS and the issue of apportionment.[8] Next, the District Court

---

[7]J.S. App. 3-2.

[8]MDA 9 through 11.

of Appeals, in its decision, stated:

3. "... the income in Shell's case was realized totally from sales of oil in the various states of the United States.[9]

In its initial brief to the Florida Supreme Court, Shell stated:

4. "To avoid confusion on the important 'exclusion' (from income) issue, however, Shell elects not to argue the apportionment issue before the Court."[10]

Next, the decision of the Florida Supreme Court states:

5. "Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states."[11]

The Solicitor General's brief contains the following two conclusions:

1. "Shell contends, however, that the States must 'back out' from Shell's apportionable tax base

---

[9]J.S. App. 2-16.

[10]MDA App. 11-3.

[11]J.S. App. 1-8.

that portion of its income deemed to derive from exploration and production activities occurring on the OCS, even though that income is not realized within the OCS through third-party sales."[12]

2. "Indeed, Shell in this Court specifically disclaims any challenge to Florida's apportionment formula. See note[3], supra."[13]

Confirmation of Shell's waivers as to its abandoned issues of fact and of apportionment is visible in the following extract from Shell's motion to compel filed post-decision with the Florida Supreme Court:

> "4. Shell can establish that the Department has in fact taxed actual sales on the OCS."[14]

Had Shell established the fact of any sales upon the OCS, this prospective offer of proof would be unnecessary and certainly is procedurally flawed. Had Shell established any sales upon the OCS,

---

[12]U.S. Br. 5.

[13]U.S. Br. 6.

[14]MDA App. 14-3.

the income realized therefrom would have been excluded by the Department in the manner established by the Florida courts which is applicable to all sales consumated by delivery beyond Florida's 3 mile jurisdiction limit.[15]

Shell, with its motion to compel, attached certain correspondence exchanged between the parties to this case. Particularly, the letter of the Department's General Counsel to Shell is expositive of Shell's abandonment of these two issues.[16]

OBFUSCATION AND DELAY

Consistent with its oral arguments before, and its post decisional filings with, the Florida Supreme Court, Shell

---

[15] Tropicana Products, Inc. v. Dept. of Revenue, Case no. CA-17-1799 (12th Judicial Cir., Manatee County, Florida) aff. Per Curiam 353 So.2d 686 (Fla. 2nd DCA, 1977), Appendix 1a.

[16] MDA App. 14-12 through 14-33.

has embarked upon a course of obfuscation of the single legal issue presented. First, the question presented to this Court by Shell is enlarged to include hypothetical elements (as to third party sales).[17] The certified question addressed by the Florida Supreme Court[18] and the question presented in the Solicitor General's brief[19] are consistent with the question presented by the Department and both exclude these hypothetical elements.

Further, Shell's jurisdictional statement references sales of natural gas upon the OCS made to third parties as well as sales of crude oil[19], which references are not evidenced in the Florida trial court record. Neither are

---

[17]MDA 16, 17.

[18]J.S. App.1-5.

[19]U.S. Br. (1)

[20]J.S. 8.

Shell's additional references to "all Shelf oil and gas production revenue from sales" and "the sales on the Shelf"[21]

Next Shell attempts to infuse the abandoned aportionment issue by stating "the Department ...included Shelf-derived oil and gas sales in the denominator of the apportionment formula."[22] Moreover, Shell states that Florida's attempt "... is the most egregious distortion of an apportionment formula ... by reason of exclusion of payroll and property factors ...."[23]

This pattern of repeated references to the two waived issues in the jurisdictional statement can and does operate to obfuscate the single issue of law encompassed in "Florida". Shell's

---

[21]J.S. 10, 11.

[22]J.S. 11.

[23]J.S. 22.

suggestion to this Court that it consolidate "Florida" with "Iowa" when the latter subsequently comes before this Court is an obvious ploy to accomplish thereby the infusion of the two waived issues. The suggested consolidation would accomplish indirectly what Shell is unable to accomplish directly, i.e., introduce factual substance to its phantom "production income". This would cloud the single issue presented in "Florida".

Moreover, "Florida" would be held in abeyance awaiting possible review by this Court of an Iowa court decision rendered almost eighteen months after the Florida Supreme Court's seminal decision. After the decision in "Florida", Shell filed a flawed petition for rehearing in which it argued the 2 issues abandoned in the trial court, thereby dishonoring its express waiver

contained in its initial brief to the Florida Supreme Court. Shell also filed a Motion for Order Compelling Compliance with Court Decision. That motion was premature when filed as the order was not yet final and in fact Shell appealed to this Court. Before this Court Shell petitioned for an extension of time in which to file its jurisdictional statement. The combined effect of these actions is to delay the resolution of "Florida" in the hope of thrusting "Iowa" into the single-issue Florida litigation. In sharp contrast, Shell offers to accelerate the filing of the jurisdictional statement in the multi-issued Iowa case in an obvious effort to further delay the resolution in "Florida". Shell's suggestion to consolidate "Florida" with "Iowa" frustrates orderly state tax

administration in the various states wherein the issue in "Florida" has arisen.

CONCLUSION

"Iowa" contributes nothing to aid resolution of "Florida", but rather an early decision in "Florida" would contribute to the subsequent resolution of "Iowa" and other litigation as well as administrative controversies pending between the oil industry and the various states.

Doubtless the combined effect of insubstantial OCS sales coupled with the absence of substantial investments made in the OCS via a property factor will focus attention on the fairness of Iowa's single sales factor apportionment method, which is a non-issue in "Florida". An early resolution of "Florida" would exorcise the ghost of two non-issues together with the spector of phantom

"production income". Shell should be held accountable for its elected litigation strategies in "Florida" in the manner this Court has applied in Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425, 434 (1980).[24] Lastly, the Department agrees with the Solicitor General that the issue in "Florida" is of no great importance to the United States.[25]

The Department respectfully urges this Court to reject Shell's suggestion to consolidate but rather separately consider each of these two cases. Accordingly, the Department renews its motion to dismiss Shell's appeal in the case subjudice or to affirm the decision of the Supreme Court of Florida for want of a proper and substantial federal

---

[24]MDA App. 14-25

[25]U.S. Br. 6

question in the manner this Court explained in Hicks v. Miranda, 422 U.S. 332, 343 (1975).

Respectfully submitted,

Sharon A. Zahner
Assistant General Counsel
Florida Department of Revenue
Carlton Building, Room 204
Tallahassee, Florida 32301
(904)488-0712

COUNSEL OF RECORD FOR APPELLEE

ROBERT A. BUTTERWORTH, ATTORNEY GENERAL

Joseph C. Mellichamp, III
Assistant Attorney General
The Capitol
Tallahassee, Florida 32399-0150
(904)487-2142

OF COUNSEL

APPENDIX

IN THE CIRCUIT COURT OF THE TWELFTH JUDICIAL CIRCUIT OF THE STATE OF FLORIDA, IN AND FOR MANATEE COUNTY, CIVIL ACTION

TROPICANA PRODUCTS, INC., A Florida corporation,	)	
Plaintiff,	)	Case No. CA-74-1799
vs.	)	
DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA,	)	
Defendant.	)	

FINAL JUDGMENT

This cause came on for hearing on the Motion for Summary Judgment filed by the Plaintiff, Tropicana Products, Inc. In support of its Motion for Summary Judgment, Plaintiff filed an affidavit of an officer of the corporation, setting forth the facts applicable to this case.

Having considered the pleadings on file, the exhibits thereto, and the Plaintiff's affidavit, it appears to the Court that the "sales" between Plaintiff and its wholly-owned subsidiary

corporations referred to in the aforementioned pleadings and affidavit should not be included in either the numerator or the denominator of Florida's apportionment statute (Florida Statutes, s. 214.71(3)) (except those between Plaintiff and Plantation Enterprises, Ltd., which Plaintiff concedes should be included). The purpose of Florida's statute is to apportion a part of a multistate taxpayer's total income from all sources to the State of Florida, in an amount roughly corresponding to the degree of the taxpayer's income-producing activities in Florida. Thus Florida has adopted a three part apportionment formula based upon the ratio between the taxpayer's Florida property and its total property everywhere, Florida payroll and its total payroll everywhere, and its Florida sales and its total sales everywhere. Under the facts of this case

the transactions between Plaintiff and its wholly-owned subsidiary corporations referred to in the affidavit do not reflect business activity of the type contemplated by the apportionment statute and thus inclusion of such "sales" would not be within the intent of the apportionment statute. Under the facts of this case the transactions are not "sales" within the meaning of Florida's apportionment statute, Section 214.71(3).

The second issue involves the method of computing Tropicana's income from foreign sales for the fiscal year ending August 31, 1972. Florida Statutes, s. 220.13(1)(b)(2) provides, in general, that in determining taxable income for Florida purposes sales outside the United States (less expenses attributable to such sales and deducted on the taxpayer's federal income tax return) are to be subtracted. In essence, net income

from foreign sales is to be excluded from a taxpayer's income for Florida purposes. The second issue in this case involves the property method of computing Plaintiff's net income from foreign sales.

The undisputed facts show that it is impossible to specifically allocate expenses to Plaintiff's foreign sales as opposed to its domestic sales. All, or virtually all, expenses incurred by Plaintiff and its subsidiary corporations are simply attributable to its overall manufacturing and selling activities and few, if any, expenses can be pointed to as being specifically incurred only in connection with foreign sales. Under these circumstances the parties agree that some type of mathematical allocation of expenses to foreign sales is called for. The problem is to determine the method of allocation.

It is the Court's opinion that under the facts of this case the correct method of determining Tropicana's net income from foreign sales is to multiply total gross foreign sales for the period in question by a fraction having a numerator equal to Tropicana's total actual net income for the period in question and a denominator equal to total sales (foreign and domestic). That is, under the facts of this case there is no reason to think that Plaintiff's net income from foreign sales is any different from its net income from all sales. Thus net income from foreign sales is an amount bearing the same ratio to the total foreign sales as total net income from all sources bears to total sales from all sources.

Net income before taxes of Tropicana and its subsidiaries for the period in question was $3,988,468.97. Total sales for this period were $31,552,133.26.

Thus the ratio of net income to total sales was 12.6%. Foreign sales were $1,685,145.00. This amount, multiplied by 12.6%, results in net income from foreign sales of $212,328.27, which amount should be subtracted from federal taxable income pursuant to Florida Statutes, s. 220.13(1)(b)(2) for the period in question.

It is thereupon ORDERED AND ADJUDGED THAT

1. The transactions between Tropicana Products, Inc. and its subsidiary corporations (with the exception of Plantation Enterprises, Inc.) should not be included in either the numerator or the denominator of the apportionment formula set forth in Florida Statutes, Section 214.71.

2. For the fiscal year ending August 31, 1972 sales in Florida of Plaintiff were $8,728,821. Total sales

everywhere for the same period were $100,048,377.

3. For the fiscal year ending August 31, 1973 sales in Florida of Plaintiff were $13,166,595. Total sales everywhere for the same period were $113,363,770.

4. Net income from foreign sales, to be subtracted in determining Tropicana's "adjusted federal income" under Florida Statutes, s. 220.13, for the fiscal year ending August 31, 1972, was $212,328.27.

5. Florida corporate income taxes properly payable by Plaintiff for its fiscal year ending August 31, 1972 are $228,571.45 and Florida corporate income taxes property payable by Plaintiff for its fiscal year ending August 31, 1973 are $421,466.45. The resulting deficiency in such taxes resulting from adjustments made by the Florida

Department of Revenue and not contested by Plaintiff, is $24,030.28 for the fiscal year ending August 31, 1972 and $30,873.01 for the fiscal year ending August 31, 1973.

Plaintiff's Motion for Summary Judgment is hereby granted in the foregoing respects and the Department of Revenue of the State of Florida is entitled to collect corporate income taxes against Plaintiff only in accordance with the foregoing.

DONE AND ORDERED in chambers at Bradenton, Manatee County, Florida, this 22nd day of November, 1976.

Gilbert A. Smith, Circuit Judge

Copies furnished to:

Brian C. Ellis
E. Wilson Crump, II